

Challenge

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from the editor

a personal note

■ WITH TAX TIME approaching and the budget for fiscal '61 up for consideration, the cost of government is a subject of vital and current interest. Some excited comment has been prompted about the huge sums going into so-called welfare programs.

For example, under the headline "20 Billions for Welfare—Story of a Growing Expense," a prominent news magazine recently unfolded a two-page story stating that "out of every \$1 the government spends, 21 cents goes for welfare."

The trouble with this type of presentation is that it confuses the cost of pension plans with the cost of tax-supported government.

Most people think about the cost of government as a tax-supported outlay. Therefore, if we are going to talk about welfare costs, a clear distinction must be made between outlays charged to trust funds (e.g., Social Security payments) and outlays covered by tax-financed budgetary appropriations.

By lumping together all "welfare" expenditures, whether paid for from the cash budget or the administrative budget, the magazine article mentioned above was able to show ever-increasing outlays by the government for welfare programs.

Obviously, a pertinent question here might be: Aren't payments made to the trust funds the same as taxes paid to the government? The answer is "yes" in terms of money

compulsorily taken from us. But would we be able to buy as much welfare if we contributed to a privately administered trust fund? This is the truly relevant question.

The relative merits of public programs against those of private ones constitute the real issue to be examined. This issue is only clouded by discussions that highlight government payments to the public while playing down contributions by the public for the specific purpose of financing the benefits. Because the public pays money to the government does not mean that these payments are a part of the *cost* of government. They represent the costs of a security program.

Now, whether provision for security should be compulsory or voluntary is another matter. Whether the government's handling of the trust fund accounts is sound or a piece of chicanery is also another matter. I am all for careful examination of these issues.

But when we speak about the high cost of the federal government today, it seems to me that we should look at only one budget—the administrative budget.

For fiscal '61 the administrative budget has been proposed at \$79.8 billion. Eighty-five per cent of this is for defense, interest on the debt, the conduct of foreign affairs, veterans' benefits and the various agricultural programs. Another 11.3 per cent covers housekeeping expenses and the bare essentials of public service. The remaining 3.7 per cent (\$3 billion) covers "welfare" items, of which \$2 billion augments state costs for public assistance.

This is somewhat different from the \$20-billion welfare expense picture painted for public scrutiny elsewhere.—H. B.

letters TO THE EDITOR

*Challenge invites your comments. Address letters to
CHALLENGE, 475 Fifth Avenue, New York 17, N. Y.*

Few "workers"

• I should like to commend you for publishing Dr. Chamberlain's brilliant article ["Organized Labor-A Diminishing Force?", January, 1960]. It is the first I have read that looks at this problem of union power, not from the point of view of what has been (or even is), but what is likely to be in the years to come. As Dr. Chamberlain points out, union organizing drives are encountering increasing resistance. Even more important, unions are no longer regarded as spokesmen for the whole labor movement. The reason for this is not Hoffa & Co., for few Americans think that such men are typical of the union movement. Rather, it is the fact that very few Americans today consider themselves "workers." Today's union is more like a professional or trade association. But its leaders have yet to learn that the language of "worker revolt" is not suitable to such groups.

ALLAN KIRK

Paoli, Pa.

Women and unions

• It is not really surprising that only 18 per cent of the women in the labor force are union members.

["Organized Labor-A Diminishing Force?" by Neil W. Chamberlain.] A glance at the tables on labor statistics in the Statistical Abstract of the United States shows that relatively few women are employed in occupational fields where union membership is prevalent. The vast majority are employed as clerical workers, sales workers, service workers or in the professions. Even those who are employed in factories are more likely to be working seasonally, in canning plants, packing houses, etc. I do not doubt that women are more reluctant to accept union cards than men, but it seems to me that most women are not employed in fields where they are likely to be contacted by unions-at present, at least.

O. C. SIMMONS

Long Beach, Calif.

Consumer decisions

• Mr. Hollander ["How Much Choice?", January, 1960] summed up the question of discretionary spending power by suggesting that "the final test of our discretion will be not how we use our money, but how we use our time." In many of our activities, however, time may be worth money. If we are accustomed to serving dinners prepared in 20 minutes

from frozen foods, sending our laundry outside the home, buying all our clothes ready-made, and having alterations and repairs made by someone else, and paying a neighborhood lad to mow the lawn, we may forget that these essential expenditures are being made out of our discretionary dollars. Our decision to save time for leisure activities may determine how much we can spend on the activities themselves.

H. L. LEVINE

Floral Park, N.Y.

The pro and the con

- Lincoln Smith's article ["The Businessman in Government," January, 1960] took more space to say less than any article CHALLENGE has run in some time.

Cleverly avoiding specific examples of both the good and the bad that can come from businessmen in government, the author ends his meandering dissertation with the lame conclusion that there are both advantages and disadvantages to having businessmen in government. Well, goody!

JOHN MORGAN

Astoria, N.Y.

Opportunity for youth

- Perhaps your article, "Intellectuals in Industry" by Leonard Silk [January, 1960] will encourage your college-age readers to reconsider an academic career. I have read many articles which deplore the shortage of university professors and warn of increasing efforts to lure them away from their profession. But Mr. Silk's article is the first I have read that shows how intellectuals are serving both the academic and the business

worlds. Such a career might sound rewarding enough to persuade young skeptics that one is not necessarily isolated in an ivory tower.

MRS. HAROLD LAYTON

Portland, Ore.

Nonagricultural income

- Reflecting on William Hendrix's article ["Part-Time Farmers," January, 1960], I was amused by the statement: "An increasing proportion of the farmer's income is being derived from nonagricultural sources."

To the occupations listed by the author I would add the practice of receiving money from the federal government for leaving fields uncultivated during the growing season. It certainly strikes me as a nonagricultural source of income. You certainly do not have to farm to be a farmer these days. A retired schoolteacher friend admits that he retired to a farm because the government acreage agreements would cover the costs of taxes and utilities. In fact, the only cultivated portion of his farm is a small family garden. Small wonder that more farmers are finding time to seek employment off the farm!

J. S. TAYLOR

Wheeling, W.Va.

Solid and meaty

- Your series of scientific interviews are of extremely high caliber. No rash predictions; no supposedly startling revelations. Just good, solid, meaty answers to some sensible questions.

Keep it up.

HARRY TOWNSEND

Peekskill, N.Y.



Challenge Notes

Bargaining "parity" for farmers; figures are not always facts in economics; bigger budgets for the next President; musical (dental) chairs

■ **THUS FAR** the fight for farm "parity" has been fought on only one front. Farmers have relied on their *political* power in Congress for subsidies which protect them against their weak *economic* bargaining position. But farm leaders realize that farm influence over Congress will diminish as the farm vote continues its historic decline.

Recently, the American Farm Bureau Federation, the largest of our farm lobbies, decided to do something about bolstering the farmer's *economic* bargaining power. The Bureau's National Marketing Association was empowered to negotiate "contract terms, quality control and related matters" with food processors, packers and other farm middlemen. Since the Bureau has a membership of some one and one-half million farm families (about one-fourth of the total farm population), such a plan could, if fully enacted, give the farmer as much parity with the rest of the

economy as the AFL-CIO enjoys vis-à-vis industrial management. The Farm Bureau scheme would, if successful, control food costs and prices from field to dinner table.

If the basic aim of a sound agricultural policy is to be bargaining parity with the rest of the economy, then there is much to be said for the Bureau's plan. But should parity be our primary goal? Or do we want the most efficient and economical agriculture possible? One thing is clear: we cannot have efficiency and economy in agriculture and at the same time try to preserve for *all* farmers the economic habits and social status they enjoyed at the turn of the century. "Featherbedding" as a way of life is no more justifiable in agriculture than in other spheres of life.

Are figures facts?

The nice thing about economic problems is that economists can usually express their conclusions in

terms of dollars and cents. This sometimes gives them an air of omniscience which they do not really possess.

When, for example, the Bureau of Labor Statistics tells us that output per man-hour has averaged a 3.1 per cent rise annually since 1947, this sounds like a solid bit of factual information. But, as economists well know, output per man-hour is an extremely tricky thing to measure. Even in the government, BLS and the Bureau of the Census do not agree. BLS measures man-hours of labor paid for while the Census Bureau measures man-hours actually worked.

Nor do the experts agree on how to evaluate the BLS figures. Even assuming that their 3.1 per cent estimate is substantially correct, does this tell us very much about our over-all performance? If we exclude agriculture, for example, the rate of productivity increase came to only 2.6 per cent a year. Since it is the nonagricultural sector of the economy that most interests us in assessing our growth performance, this would mean that productivity has not changed substantially since the end of World War II. But the fact that economists should debate such a basic issue indicates that economics is still very far from being a science.

"Uncontrollable" outlays

Even if business conditions and

the Congress enable the President to realize his estimated \$4.2-billion surplus for fiscal 1960-61, it is certain that his successor will have to ask for a bigger budget during the next fiscal year—even if he does not embark on new spending plans. The next President will face big, "uncontrollable" outlays in such things as veteran's pensions, to which he is legally committed. He will also face "built-in" increases on such long-range programs as public works, many of which the current Administration initiated. Unless, therefore, the next President can substantially *reduce* the number of programs, it is unlikely that he will be able to maintain the budget at its current level—much less cut it further.

Drilled-in stereo?

Some modern music sounds like a dentist's drill. According to Drs. Wallace Gardner and J. C. R. Licklider of Cambridge, Mass., the dentist's drill of the future will sound like Bach, Beethoven and Brubeck. They have found that stereophonic sound is an effective pain killer for dental patients. Their system includes earphones that can bring music to both patient and dentist. We have two questions: Who controls the volume? And what happens if the dentist is an Elvis Presley fan? Some patients might prefer a toothache.—M. K.

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dilemma •
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full employment **OR** inflation

by Edwin G. Nourse

■ THE FEAR OF massive postwar unemployment was the predominant force leading to the prompt and sweeping passage of the Employment Act of 1946. Early proponents of the Employment Act, and particularly the framers of the "full employment" bill that preceded it, had conceived the problem in rather simple terms. Men and machines would be fully employed, and high and sustained prosperity would be assured, if the central government "opened the money spigot" wide enough; and inflation would be prevented by the government's "reversal of the money pump."

During the 13 years since passage of the Employment Act, business conditions have been very favorable and performance of the economy in the main quite gratifying. But during the 1957-58 re-

cession, industrial prices and service rates experienced a continued rise, while unemployment persisted or even mounted. It appeared that, *under the institutions and mores of our enterprise economy, opening the money spigot wide enough to get full employment results in dangerous inflation, and reversing the money pump drastically enough to prevent inflation produces intolerable unemployment.*

This was highly disillusioning to many who had felt so confident that the use of fiscal and monetary powers by the federal government could be relied upon to accomplish maximum production and real consumer purchasing power. Growing doubts became manifest in an increasing amount of discussion of recent and current price phenomena under the label "cost-push inflation." I myself have been moved

to call it "institutionalized" inflation—that is, an inflationary trend built into the market process through the institutions of the large corporation, the big union, and big government influenced by special-interest groups. This institutionalized inflation reflects the conditioning structures of business, labor and government. Perhaps more important, it also embraces the attitudes and practices of the corporation executives, union leaders, and Administration and Congressional officials who are our effective cadre of policy-makers.

"Mixed" economic system

Our American "mixed" economic system must be visualized as a global process made up of (a) a hemisphere of private business administration and (b) a complementary hemisphere of public economic administration. The private hemisphere is divided into quarter-spheres of (a1) capital administration or price-investment policy and (a2) labor resource administration and wage negotiation. Similarly, the public hemisphere is divided into quarter-spheres of (b1) credit administration and (b2) spending-taxing administration. My attention will be primarily directed to the former areas—the price-and-wage-making process that is the source of cost-push inflation.

The primary problem raised by the Employment Act is not what

kind of public action should *compensate* for failure of the private economy to effect sustained big production. The basic and really tough problems are how to *forestall* such failure by improving the institutions of the market—for goods, for services and for funds—and how to raise the mores of individual and administrative responsibility to a level compatible with the character of modern industry and trade. Concentrations of private economic power are necessary for the efficient handling of our fast-advancing technology. But, without curbing the efficiency of these powers, we need to do much more in effecting disciplines within and among these big units.

Thus, the basic issue posed by the Employment Act is how competition shall be defined in a day of Big Business and Big Labor, and how it shall be implemented toward the attainment of national growth and stability. Big-unit competition must find an optimum blend of internal constraint and cooperation.

The broad strategy that should guide our campaign for dealing with the corporate and the union quarter-spheres of our economy should do more than preserve "free competitive enterprise" merely as an abstract ideal. Rather, it should make that freedom, and the competition that results therefrom, achieve maximum consumer real purchasing power.

Under our traditional principle of free private enterprise, the ambition, the ingenuity and daring of business leaders have developed the industrial and the commercial corporation to unprecedented size and influence. A single firm may hold assets, develop money flows and control personnel to an extent that exceeds the economic power of many of our sovereign states and many a foreign country. The horizontal and vertical integration permitted under the law has contributed powerfully to the stimulation of production, the enlargement of employment opportunities and a marked rise in the real purchasing power of consumers.

Its impact on national stability has been more equivocal. The extreme business cycles of the past may indicate that relatively few centers of decision-making can give the economy a speculative overstimulation at one time and retard the revival of confidence and activity at another. Recently, however, there seemed to be grounds for believing that long-range research, planning for future national needs, and expert inventory control and investment programming have made big-unit business a potentially important stabilizing force in today's and tomorrow's economy. Unfortunately, the inflationary price spiral now challenges that benign prospect.

Paralleling the development of

the giant corporation, under our system of free private enterprise, is the development of labor unions of enormous size and power. In many regards the scope of these labor unions approaches and even surpasses that of the largest corporations. Much as the "infant industry" argument in the manufacturing area became an absurdity, so the "underdog" justification for enlarging the rights and the benefits of organized labor has become obsolete. The workability of a system of free competitive private enterprise under modern conditions pivots on the institution of collective bargaining. It had seemed an almost axiomatic proposition that bargaining between units of unlimited size could have the same beneficial effects as those traditionally ascribed to bargaining between very small units, if "equality of bargaining power" could be achieved.

Distressing alternatives

However, instead of promoting market equilibrium through rational juxtaposition of supply realities against demand realities, each side sought to maximize its fire power in order to force a decision to its financial advantage. The consequences of this line of development seem now to have brought us to the distressing alternatives of inflation or a return to the class struggle impasse.

When J. K. Galbraith undertook to beatify "countervailing power" as the method of resolving market problems, he had to admit that the equal power solution was tenable only in a "deflationary" market situation. "When there is inflation," he said, "the self-regulatory mechanism based on countervailing power ceases to be effective. It takes on, instead, a malignant form which becomes part of the dynamic of inflation itself." In fact, this statement should go one step further to say, "It takes on. . . a malignant form which becomes a prime initiating force in inflation." Recent experience makes it clear that the present concentrations of economic power generate inflationary pressure with which both fiscal and monetary action has to "go along."

Race for power

Reliance, then, on collective bargaining between monopolist equals (management and union) is seen to be fatuous. Instead of an apparatus of wholesome adjustment, we get a dangerous race for more power on both sides and impasse when the summit is reached. Neither party is willing to admit that its power is equal if it has to accept contract terms below the level of its demands. To paraphrase George Orwell's brilliantly satirical phrase in *Animal Farm*, "Both pigs must be equal, but each pig

must be more equal than the other."

With the growth of industrial unionism (which has indubitable justification and potential benefit), monolithic organizations of workers acquired tremendous powers, both of initiation and of resistance, in several of our key industries. In the sellers' market of the postwar period they developed the very effective tactic of pressing their attack against that major employer who appeared at the moment to be in the most vulnerable position or to have a recognized position of policy leadership. The success of this union tactic in previous instances moved the steel companies to confront the solidarity of the United Steelworkers with the matching solidarity of the 12 major companies in this oligopolistic industry. But this "reverse English" on the quest for equality of bargaining power promptly engendered a countermove toward a still larger solidarity among unions as a whole. Separate unions passed resolutions to support the Steelworkers in their strike. The AFL-CIO and several individual unions not only gave unequivocal moral support but also voted substantial cash subsidies to increase the defensive power of the steel union.

Under our antitrust principle we have turned back at the front door the possibility of industrial cartels. Do we not see in the race for defensive power between labor and

management the cartelization of industry coming in by the back door? Whether or not the Department of Justice will challenge this development remains to be seen. Thus far the monolithic labor suzerainty has been able to maintain substantial immunity from the antitrust laws.

One-way street

The dual market-power structure has produced a price-raising spiral in which the glitter of corporation profits has moved unions to clamor for what they regard as "their share." Management, in turn, has marked up product prices by amounts corresponding to the higher prices unions are exacting for their members. Sometimes management even adds something more to price markups as a margin of safety. Thus, price and wage "adjustment" becomes a one-way street leading to inflation.

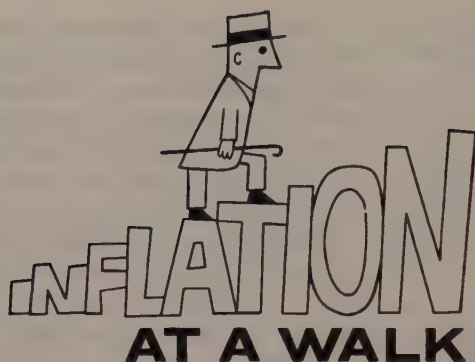
Something radical or at least showing sparks of inventiveness needs to be done to check the erosion of that competitive flexibility that is needed for a free enterprise economy. The list of the rigidities that have slipped into our system as compromises of the moment during the Great Depression and the postwar boom is long. A few choice samples include agricultural "parity," national wage bargains, internal financing of corporate growth and technological change with little reference to the more detached

judgment of the investment market, wage escalation by both cost-of-living and average productivity factors, stockpiling subsidies, "pattern" wage settlements, and price leadership and the taboo on price competition within industries.

Our traditional theories of competition developed long before these operational complexities emerged. Edward Chamberlin's pioneer study of monopolistic competition took a long stride forward into the realities of today's industrial and commercial life. But the focus was on maximization of the profits of the firm. There needs to be an enlargement of this type of theory to encompass maximization of the productive and distributive dynamism of the whole economy.

Public inquiries and private studies are now seeking to determine what present concentrations of economic power are inimical to the intentions of the Employment Act. They are also seeking to establish the steps that should be taken to carry out the intentions of the Act. Thus far, the inquiries of the Joint Economic Committee and the Senate Subcommittee on Antitrust and Monopoly have not given us a clear road map to these ends.■

Next month Dr. Nourse will conclude this two-part article with concrete suggestions on how the dilemma of "full employment or inflation" can be resolved in the context of a free, competitive enterprise system.



Because most people will continue to assume the stability
of the dollar, runaway inflation is unlikely

by John H. Kareken

■ INFLATION is certainly much in the news these days. One is hard put to think of a more discussed domestic political issue. Economic growth? Perhaps. But then economic growth is to inflation as good is to evil. They are inseparable—at least in the debate going on about us.

It is natural, other things being equal, for us to prefer a greater to a lesser increase in our standards of living, and a stable price level to a rising one. But what if advancing living standards can be had only at the price of inflation? There are those, like the late Prof. Sumner H. Slichter of Harvard, who readily admit that the dilemma exists; but they would unhesitatingly accept continuing *mild* infla-

tion in exchange for a growth rate greater than our nation has enjoyed in recent years.

There are others, though, who take vigorous exception to this point of view. It is, they insist, an impossible compromise. There is no such thing as continuing mild inflation, just as there is no such thing as being a little bit pregnant. According to those who urge an all-out "defense of the dollar," it is the nature of things for a persistent gradual inflation to accelerate into a rapid and uncontrollable inflation.

Yet, why must creeping inflation become galloping inflation? Why is it not possible to go on year after year experiencing, say, a two or three per cent increase in the price

level? The usual answer emphasizes the reactions of economic units, families and business firms, to even gradual price advances. It is argued that when faced with the increasingly certain prospect of eventual higher prices, individuals will be less inclined to save. And, where they do continue to save, they will invest not in bank deposits and bonds, but in stocks, real estate and physical commodities. Similarly, businessmen will see advantage in holding larger inventories of raw materials and finished goods. Longer-term investments, like new plants, will also appear more profitable.

Most of these responses—described as hedging against inflation or beating the price rise—serve to increase the *present* demand for goods and services, and thus bring on the very thing anticipated—higher prices. Then, too, the greater the rate of current price rises, the greater is the incentive to anticipate future increases and thus to accelerate price advances.

This argument has the aura of inevitability about it. How natural such responses seem. Yet those who take the opposite view, that inflation can continue at a moderate pace, appear to have history on their side. Prolonged periods of gradual but persistent price increases are certainly not uncommon in our history. In the 50 years after 1720, for example, wholesale

prices increased steadily, but this creeping inflation did not become a galloping inflation until the onset of the Revolutionary War. During the decade or so prior to the Civil War, much the same sort of price behavior was evident. And from 1896 through to the start of World War I, both wholesale and consumer prices rose steadily, though again without any marked tendency toward acceleration.

Nor should the record of the recent past be ignored. The so-called implicit price deflator for the gross national product, which is the most inclusive measure of the price level, has increased in every year but three since 1933. And during the postwar period, as everyone is aware, prices have increased considerably. The consumer price index, with 1947-49 as a base, stood at 77.5 in mid-1945; by mid-1959 it had reached 125.2. The wholesale price index, on the same base, rose from 68.9 in July, 1945, to 119.7 in July, 1959.

The harbingers of galloping inflation, however, are not so evident. Both business and household savings have shown no systematic response to price level changes. Total saving, of course, fluctuates from year to year; but these are largely caused by fluctuations in total income.

People sometimes point to the postwar behavior of the stock market and to the growing interest in

mutual funds as indicators of an ever-spreading fear of inflation. But it is easy to find other reasons than hedging against inflation to account for these developments.

The famous, or infamous, bull market of the 1920s cannot be traced to any great fear of inflation. It is more likely that the economy simply got caught up in its own optimism. Not thinking of rising prices, people became increasingly convinced that large profits were to be had from stock market investments, and so switched from other forms of wealth. Surely this sort of thinking, justified or not, prevails today. Moreover, with the postwar increase in per capita income, we can expect families with sufficient savings to want to try other types of investment. Diversification of investments is a common practice.

Stiffer competition

It can also be noted that traditional forms of wealth are not disappearing from the scene. True, some types of financial intermediaries—mutual savings banks and, to a lesser extent, commercial banks—are having a hard time of it. But these institutions seem to be losing out not so much to the stock market as to savings and loan associations, which also deal in fixed-income claims. Nor can the apparent demise of U.S. government securities be attributed wholly, or

even in large part, to fear of inflation. It is more likely that other fixed-income assets—again, primarily savings and loan shares—are offering stiffer competition, partly because, unlike government securities, they do not fluctuate in value from day to day.

Finally, it must be pointed out that life insurance is far from becoming a relic of the past; sales of new life insurance have fared well since the war. The record, then, simply does not show a growing aversion to fixed-money assets which cannot increase in value, as corporate stocks do, when the price level rises.

Obviously, this interpretation cannot be pushed to an extreme. Undoubtedly, some of the recent participation in the stock market is motivated by a desire to hedge against inflation. But what is the harm of this? Stock prices, after all, do not figure in the cost of living. The anticipated danger probably is that the "Great Crash" will be repeated in all its horrors, and that the economy will be prostrated by the collapse of the speculative binge.

Such a prospect is not pleasant to contemplate. It is a remote prospect, to be sure, but it cannot be dismissed. Federal Reserve power over the stock market, though augmented since the 1920s, is probably not sufficient to keep speculative fervor bottled up. And it

would not be a good idea to subject the whole economy to severe credit restraint in order to put downward pressure on stock prices.

Needs and shortages

More serious, though, than a flight into corporate equities is the possibility of a flight into actual commodities, largely because the latter affects the inflation problem more directly. Just after the outbreak of the Korean war, individuals, remembering World War II, began to buy goods in anticipation of future needs, and prices rose rapidly. Yet, even in this instance, people seem to have been more concerned about future shortages than about higher prices. Furthermore, there is little evidence that families now are filling their larders, or buying commodities in amounts greater than they can consume in the ordinary course of living. They are saving, and disposing of their savings, much in the manner of the past.

This should not be surprising, for actually the great majority of the population can do little about the prospect of higher prices. Some consumer goods, like personal services and nondurable commodities, cannot be stored away but must be bought as needed. Of course, durable goods can be used as a store-of-value. But where are they to be stored? And who can be sure that style changes will not make last

year's model a relatively worthless thing?

There are always corporate stocks. Unfortunately, however, they are a gamble. And why should individuals take a gamble involving the possibility of considerable losses, instead of taking a surer, but more moderate, loss?

In general, then, it does seem that the costs and risks of attempting to hedge against inflation are great enough so that for many people it simply is not worth the try—at least as long as the outlook is for *moderate* and intermittent price advances, which is what our recent history suggests is most probable.

Clearly, the greater and the more certain the anticipated price increase, the more likely are individuals to try beating this prospect. Probably, therefore, some rate of price increase can set off an inflationary process which will feed on itself. Then hyperinflation, or runaway inflation, is just around the corner. To think that such a sharp initial price advance is in the offing, however, is to misread history.

Not that the United States has not experienced price increases large enough to spark a hyperinflation. It has. In the main, though, such price increases, and the resultant drastic inflations, have resulted from severe disruptions in the normal course of economic life. Both Lord Keynes, the capitalists' saviour, and Comrade Lenin, the

capitalists' bogieman, are often credited with a basic truth: one of the surest ways to destroy a society is to greatly inflate its currency. As a matter of history, however, cause and effect would seem to be reversed. When, for whatever reason, the social and economic organization of a country has been badly strained so that the output of goods and services cannot be increased, the way to hyperinflation has been opened. But generally not until then, or so history would suggest.

It can be argued that history lies; that the present-day situation is so unlike those of the past as to make the lessons of history inapplicable. Never before has the government undertaken to guarantee full employment. And so never before have households, businesses and trade unions been able to count with such certainty on such a "rosy" future, and been in a position to throw economic caution to the winds. This, we must admit, is a telling argument. It may well be that in present political circumstances secular inflation is unavoidable.

This, however, is not the point at issue here. The problem is whether or not this secular inflation, if it

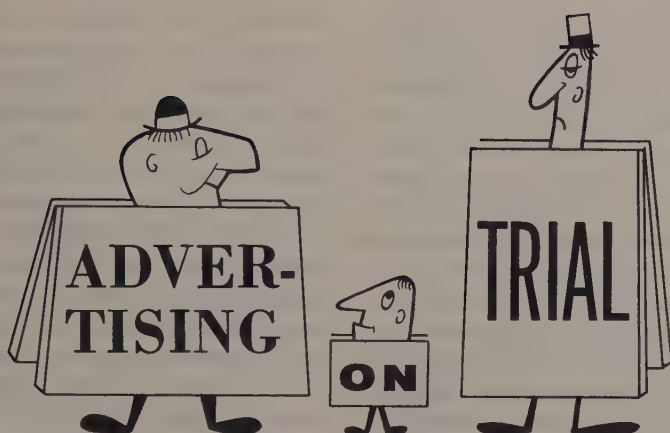
continues, will remain moderate. The answer, as the foregoing suggests, is probably "yes," particularly for a country which has not recently had to live through the agonies of true hyperinflation.

If the Federal Reserve were to give up its fight for a "stable dollar," or if the government were to start the printing presses rolling at high speed, we would be in for a bad time. Or, to take another extreme, if the government were to let its concern for inflation lead it into policies which would produce widespread and continuing unemployment, hyperinflation might result from efforts to increase employment. The political appeal of extreme economic policies would be increased considerably by the return of serious unemployment.

But who in his right mind thinks any of these extremes likely? No, the prospect is for an economic policy which over the long run will not be overly successful in containing mild inflationary pressures. But if the surmises and interpretations recorded above are substantially correct, the prospect is also for an economy free of runaway inflation. ■

Underwater Computers

AT PRESENT, an atomic submarine requires a crew of 100 men; in the future a crew of 12 will be sufficient—with a "crew" of computers doing most of the work. Computers will collect, store and disseminate information to operate the sub at top efficiency.



No verdict can be reached because there is still
no way to relate advertising effort to sales results

by Victor R. Fuchs

■ A GROWING NUMBER of advertisers are questioning the amount of money they are investing in advertising.

Media, with a few distinguished exceptions, have abdicated their responsibilities to refuse advertising not in the public interest.

Had these charges appeared in a consumers' association house organ, a muckraking popular journal or an esoteric economics textbook, they might be dismissed as the work of ignorance, prejudice or faulty analysis. But when they appeared in *Printers' Ink*, the widely read "weekly magazine of advertising and marketing," it became obvious that all is not well on Madi-

son Avenue. This \$11-billion industry is under an attack sharper and more penetrating than ever before. The answers it gives, or fails to give, may well determine its future role in our society. The most basic point at issue is the question of the value of advertising to the individual businessman, the economy and society.

From the businessman's point of view, advertising has value only insofar as it contributes to profits, present or future. The question, "How much advertising should a firm do?" can be answered theoretically in terms of economic concepts of marginal cost and marginal revenue. A profit-maximizing firm should increase expenditures

for advertising until the last (marginal) dollar spent brings in only one extra dollar of profit. The economist agrees completely with that successful pioneer in advertising, Gerard B. Lambert, who wrote, "...when sales of a product and the advertising are both running along on a level, a company can wisely spend an *additional* dollar on advertising, even if that dollar brings in net only an additional dollar and one cent." Implementing this marginal principle, however, is difficult, because it is frequently impossible to determine the portion of sales and/or profits attributable to advertising expenditure.

This is not always the case. The effectiveness of direct mail advertising, keyed coupon ads and department store newspaper ads can frequently be measured with great accuracy. But for the billions of dollars poured into TV and magazine ads, the best that can be hoped for is to measure the number of people "exposed" to the message. This leads to the tremendous emphasis on circulation and TV audience rating scores. More sophisticated practitioners in the field are, of course, aware that many things other than "exposure" affect the sales-producing effect of advertising, but a clear-cut, measurable connection between advertising expenditures and profits has yet to be established.

In desperation, advertisers cling

to such questionable measuring rods as "How much are my competitors spending for advertising?" Or they make ad appropriations after allowing for all other costs. Relying on industry-wide averages as guides to advertising appropriations bothers the scientific-minded businessman and reinforces the nagging notion that if less were spent, all would benefit. Advertising agencies can, like Salvation Army lassies utilizing fallen men, point to backsliders who have attempted to abandon or decrease advertising appropriations with disastrous results. But negative proofs are never the most convincing, and inevitably the question arises: Would sales have fallen off so precipitously if all competitors had cut back, rather than just one?

Unsavory competition

This huge question overhanging advertising budgets undoubtedly helps explain advertising agency behavior and their manner of competing for business. When the customer (in this case the advertiser) buys a blind product, competition among sellers is most liable to become unsavory. The cure usually lies in state intervention through licensing, grading or similar devices, and/or self-policing on the part of the sellers.

If "admen" could more precisely document their values to their customers, they would undoubtedly

sleep more easily. But their troubles would still be far from over. One reason is that it is possible for advertising to be a blessing for the businessman and still be called an evil for its effects on the economy. Moreover, industry will never really feel secure until the public, or at least its articulate members, can accept advertising as being a contribution to general, as well as to economic, welfare.

Informative and educational

The strongest arguments for advertising are that it is informative, and that it lowers distribution costs and makes possible inexpensive mass media of entertainment and education free from government or political control. Often exaggerated by defendants of advertising, the first point is frequently underestimated by its critics. Most department store newspaper ads, for example, are primarily informative and clearly help to enhance consumer satisfaction. Similarly, consumer knowledge about new products, ranging from cameras to cookie mixes, depends to a considerable extent upon advertising. On the other hand, it is highly unlikely that the expenditure of over \$900,000 on 19 different pages of a single issue of *Life* (December 14, 1959) was necessary to inform the public of the pleasant feelings which follow the imbibing of alcoholic beverages.

Analyzing the role of branded advertised products in lowering distribution costs is both theoretically and empirically difficult, but it can be generally agreed that, under certain conditions, these costs *are* lowered by advertising and that these conditions are probably present in some American industries. Anyone who has ever shopped in an Oriental bazaar can appreciate some of the commonly accepted conveniences of branded products.

Perhaps advertising's most secure claim to a permanent role in our society is its part in subsidizing mass media. Advertising provides more than two-thirds of the total revenue of the publishing media and absorbs all the costs of broadcasting. While this relationship may lead to other abuses, it has enabled the public to enjoy some high quality news coverage, discussion and entertainment at modest or zero prices. The early history of newspaper publishing in this country, when most papers served as voices for political parties, is not a pretty one. The prospect of state control of publishing, Russian style, is not appealing; although the British Broadcasting Company provides some evidence that it is possible to have a tax-supported public information medium function free of political pressures and prejudice.

The principal arguments against

advertising are, not surprisingly, the opposite of those in its favor. It has been argued, first, that advertising decreases consumer satisfaction by misleading claims and charges; secondly, that advertising increases the cost of goods; and, finally, that advertising exercises undue control over mass media, and that this control results in the distortion of truth and the debasement of taste.

The extent to which advertising misleads the consumer cannot be accurately measured, but the number of claims and counterclaims made by many of the largest advertisers suggests that attempts to deceive or at least mislead are widespread. Questions such as "Does aspirin upset the stomach?," "Which gasoline gives the most miles per gallon?" and "Do cigarettes cause cancer?" are not likely to be answered impartially by advertisements. And when four competing brands of cigarettes boast that each is "lowest in nicotine," three are surely conveying *misinformation*.

Impact exaggerated

The public generally tends to exaggerate the impact of advertising costs on the final price of goods and services. Nevertheless, it is true that ad outlays are currently running at close to four per cent of personal consumption expenditures. It is also true that this

percentage has increased every year since 1947. Should this trend continue, the allocation of resources to advertising could become serious. At present, advertising does not impose a major burden on the prices of most commodities; but it is extremely important in selected fields such as proprietary medicines, cosmetics and some specialty food items.

Chicanery and ethics

Probably the most serious charge facing advertisers—the one largely responsible for their current predicament—is that they control the advertising media and hence are responsible, for example, for the low quality of most TV programs and for the chicanery and unethical practices revealed in the operation of that medium. That advertising agencies and sponsors do control TV programs at present can scarcely be denied. Whether they should be permitted to control them is subject to debate, and to most outside observers the arguments for eliminating this control are persuasive. TV programs are transmitted by virtue of the use of a scarce public resource, granted by the state to private interests. The idea that such resources can be used more for the pursuit of private profit than in the public interest offends common sense.

Two other arguments in favor of advertising are that by facilitating

large-scale production it lowers costs; and that by stimulating demand it helps create jobs and economic growth. It is not clear why, if firms operate under conditions of decreasing costs for larger outputs, price or value competition alone would not result in the concentration of production in a few large firms even in the absence of advertising. Indeed, the argument can be turned around and, with greater logic, state that the product differentiation which advertising encourages prevents the full utilization of decreasing costs in a single firm. Hence the cost of production is raised.

Two-edged sword

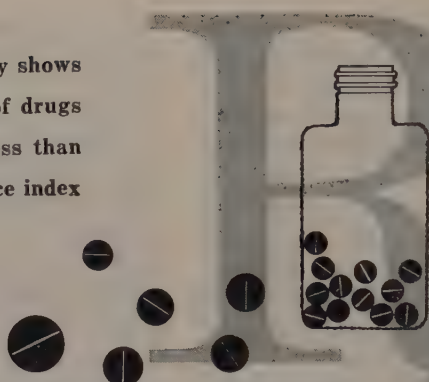
What effect does advertising have on the general propensity to consume? This question has scarcely been touched by serious research. Simon Kuznets' data suggest that consumption has tended to be a fairly stable percentage of income over a very long period of time, including decades of negligible advertising expenditures. To the extent that advertising increases total spending out of any given amount of income—rather than divert it from one form to another, as many economists believe—the argument can be a two-edged sword for the industry. For surely the most persistent problem of the postwar period has been inflation, not unemployment, and the

argument suggests that one way to restrain excessive spending and avoid inflation would be to curb advertising. Similarly, insofar as advertising increases our preoccupation with consumption and the material pleasures of life, it is destructive of those higher values which the philosophers and teachers of all ages have assured us are at the core of social progress and individual fulfillment.

Actually, it is in the sphere of moral and social values that advertising will ultimately be judged. And the criticisms made of advertising in this respect are often misplaced. The addiction to alcohol or tobacco, for example, did not begin with advertising nor would it disappear if advertising were abolished. The wearing of cosmetics is as old as civilization. Madison Avenue did not invent lust, greed, envy or fear any more than did our religious leaders invent love, faith or charity. If we hold one calling in higher repute than the other, it is because it appeals to that which we regard as the "better side" of man.

A verdict at this point would be premature. We really know little about advertising—its impact on consumers, its effect on prices, its role in the business cycle and economic growth, its social and political implications. The most compelling conclusion which emerges is the need for objective research on these questions. ■

A careful study shows
that the cost of drugs
has risen less than
the consumer price index



PILLS, PRICES and POLITICS

by Jerome B. Cohen

■ SENATOR KEFAUVER's sensational "blitz" against the drug industry got off to a headline-catching start with allegations of markups of 1,000 to 7,000 per cent. But when facts presented on the second day of the hearings showed the markup on Schering's prednisolone to be 16 per cent, not the 1,118 per cent alleged, and Dr. John Blair (Kefauver's economic brain) admitted that his markup estimates did not include selling, distribution, research or general overhead costs, the second-day headlines were nowhere as large as the first day.

It is, of course, Dr. Blair's view that administered prices cause inflation. When the smoke of this investigation blows away and the eco-

nomic facts are in, however, he is likely to derive little comfort for his views from the drug industry. For the facts are that this industry has probably contributed less to inflation than almost any other American industry.

It may come as a surprise to many but over the past 20 years prescription costs have risen less than all other consumer prices; they have risen less than medical care costs, less than men's haircuts, less than shoe repairs, movie admissions, automobile repair or laundry service, or the cost of a ride on a public conveyance.

Furthermore, percentagewise, expenditures on drugs in the post-war period have risen less than personal expenditures for housing,

for household utilities such as electricity and gas, for telephone, legal, bank, brokerage or life insurance services, for interest on debt, for transportation, purchase of automobiles and their repair and upkeep, on gasoline and oil, on radio and television receiver purchases and their repair, on foreign travel. If Dr. Blair is looking for the basic causes of erosion in family budgets, he is looking in the wrong place.

The drug industry is usually classified in two major categories; proprietary and ethical. Proprietary drugs are those which can be purchased without a prescription: ethical drugs require a prescription. Sales of ethical drugs now amount to about \$2.5 billion a year at the manufacturers' level. Proprietarys amount to about \$500 million a year. The industry is not markedly concentrated like steel or automobiles or aluminum, as there are more than 1,200 manufacturers of pharmaceutical products. No one company has more than 10 per cent of the total market. A dozen companies do about two-thirds of the volume.

In new product development, in product improvement and in product differentiation, intense competition resulting in very large research expenditures has remade the modern ethical drug industry. Seven out of 10 prescriptions today call for drugs unknown to

medicine prior to World War II. Of all prescriptions written today, 90 per cent could not have been filled 20 years ago. More than half of all drugs in use now were unknown in 1939; a very large portion have been developed only within the past decade.

Developing a promising research idea into a product usable by the practicing physician is a long, expensive and risky process. First, of course, it is necessary to discover a drug that shows promise in a major area of disease not yet conquered. Next, it must be isolated, identified and purified in the laboratory. Then the drug must be tried out on animals to establish its effectiveness and its safety. Next, physicians, usually working in hospitals or clinics, try it out on patients and study the results. Finally, processes and procedures must be developed to produce the drug economically on a commercial basis. Thousands of products are thus tested, few materialize.

When a product is successful, competitors try to make it obsolete. Almost overnight, an alert rival manufacturer may enter the field with a closely similar, but more effective product, which produces fewer or less severe side effects or which can be manufactured by a better process at less cost. The miracle drug of today is relegated to history tomorrow.

To large preliminary research

costs, for the many unsuccessful products as well as the few successful ones, must be added the costs of patent litigation usually accompanying the introduction of a new product and the costs of promotion and distribution. Thus successful products must carry the costs of past development and provide funds for present research to develop tomorrow's products. And since no manufacturer can estimate the life of his new miracle drug—and, indeed, fears from experience that it will be quite short—he has a strong incentive to try to recoup outlays for research and development as quickly as possible.

Characteristic pattern

As a result, the price history of most new drug discoveries shows a characteristic pattern of a high initial marketing price that falls sharply with volume production and market acceptance, then tapers off to relative stability. For example, a government report notes:

"Prices of new drugs follow a characteristic pattern of decline after initial introduction when volume use and production take place. Penicillin in 1943 sold for \$20 per 100,000 units in injectable form. In 1956, it sold for 20 cents per 100,000 units in tablet form, a drop of 99 per cent. Since its introduction in 1950, cortisone has dropped 90 per cent in price. Within two years of its introduction,

cortisone fell from \$200 per gram, when made from animal bile, to \$50 when made from yams and other plants. Streptomycin dropped 40 per cent in less than a year. Insulin now costs about six per cent of what it did 30 years ago, shortly after it was introduced."

Not only are the prices of individual drug discoveries reduced as volume production and market acceptance develop, but the very development of the new drugs themselves has reduced the cost of illnesses. For example, 20 years ago it took three months' salary to pay the hospital, doctor and drug bills for a case of pneumonia. Today, pneumonia is generally treated at home with only some 12 capsules of tetracycline, at about 50 cents per capsule, or a total cost of \$6 for the average case.

A generation ago, a mastoid abscess required a difficult, painful operation, costing about \$1,000 and involving the possibility of permanent impairment of hearing. Today a few dollars worth of antibiotics clears up most cases at home without surgery. The diabetic, who used to face a two-to-one chance of an early death in a diabetic coma now lives out his normal life expectancy on a drug, taken orally, whose daily cost is little more than half the price of a package of cigarettes. For five cents a day, an epileptic who was once a burden to himself and his family can now be a

productive, self-supporting citizen.

The pharmaceutical industry has not been equally effective in all fields. Millions have been spent to find drugs to control heart disease, high blood pressure and cancer, thus far without a major breakthrough. In an article last year entitled, "New Anticancer Drugs May Soon Be Ready for Use," *The Wall Street Journal* noted that "So far, the government has poured between \$60 million and \$70 million into the program," while "drug companies are spending an equal amount." Parke, Davis & Co., which recently opened a new \$13.5-million laboratory, said it was spending 50 per cent of its research budget on the riddle of cancer.

Competitive necessity

Drug industry research expenditures have been mounting steadily, increasing from \$35 million in 1947 to \$200 million in 1959. Drug research now represents about seven per cent of each sales dollar, compared to a general industry average of approximately two per cent. Research payrolls in bigger companies number 700 to 800, with a few in excess of 1,000. Large research expenditures have become a competitive necessity in the drug industry.

Since each of the major ethical drug manufacturers maintains a large research staff and their scientists exchange papers, ideas

and views at scientific meetings, it is not unusual for three or four companies to be working along the same lines on a drug to cure a given, as yet unsolved disease problem. When a breakthrough comes at about the same time in several companies, as often happens, patent applications are filed within months of each other by different companies. Interferences occur at the Patent Office and costly litigation is engaged in over alleged patent infringement. Occasionally such suits will be settled out of court by cross-licensing and royalty payments. It has become increasingly important to be first both with the discovery and in marketing the product.

In cases where a patent issues, with attendant litigation among the several claimants—and this is settled by cross-licensing—an absolute barrier to entry exists, and stable and uniform prices are likely to result. This is particularly so, since demand for the drug is very likely, in a short while, to become inelastic. An oligopoly situation results from the patent award and cross-licensing. There are a few large producers. Originally the price may have been set by the first company on the market to achieve a target rate of return on investment. Subsequently, but before the patent issues, the advent of other competitors, volume output and market acceptance brings the

initial price down. Now the patent issues and two or three companies are licensed to produce. No others can enter. Each of the producers knows that any reduction of price on his part will be quickly matched by his few competitors. If he lowers his price, they must follow suit or largely lose their share of the market, since the drug is generically the same, though each company is marketing it under a different trade name.

Self-defeating

Knowing that competitors will match a price reduction at once, is any advantage to be gained from such action? In the face of inelastic demand, the answer must be "no." A reduction in price will not result in a proportionate increase in demand. Since demand, in the short run, is governed by the incidence of disease susceptible to effective treatment by the drug, doctors will prescribe the drug, in almost all cases where they believe it will treat or cure the disease effectively, whether the price is 25 cents, 50 cents or 75 cents a capsule. Thus price reductions become self-defeating. All companies, now selling at the lower price, have neither increased the size of the total market, nor have they increased their share of the market. All they have done is to decrease their total revenues. Aware, therefore, of the compellingly probable action of their

competitors, and consequently of the self-defeating nature of price reductions in the face of inelastic demand, the incentive to reduce prices will be weak. Consequently, stable and uniform prices are likely to result in such a situation. Clearly, patents have an important impact on price behavior.

Competition has many facets, however, and companies are likely to compete through increased marketing and promotional efforts, through free goods and samples, by product differentiation and improvement. All major pharmaceutical manufacturers have large detail staffs. Both Lilly and Upjohn, for example, have more than 1,000 professional service representatives or "detail men." These men, who usually have a degree in pharmacology, call on the country's 160,000 licensed doctors to acquaint them with the company's ethical products.

Since ethical drugs may be sold only on prescription, and doctors write the prescriptions, the detail man explains to the doctors the characteristics and merits of his company's products to persuade the doctor to prescribe by trade name rather than by generic drug name. Most states require retail druggists to fill prescriptions exactly as specified.

Furthermore, most drugs sold on prescription have date limitations because of a decrease in potency

and effectiveness over time. Drugs remaining on the pharmacist's shelf beyond the stamped date, may be returned to the manufacturer for either a refund or a fresh supply. It, therefore, does little good in most cases to try to sell to the retail druggist. A company could fill his shelves with its product but if these products were not prescribed, the drugs would in due course be returned to the manufacturer. For these reasons pharmaceutical manufacturers concentrate their detailing effort mainly on physicians.

Disguised price competition

Detail men customarily give away free goods and samples. The latter are usually given to doctors, the former to hospitals. Free goods are regular stock packages given to larger purchasers, such as hospitals, as a kind of disguised price competition. They reduce the effective price to the hospital but localize the price cut. Eventually, detailing, promotion and free goods like price competition, tend to become self-defeating, since all firms follow suit.

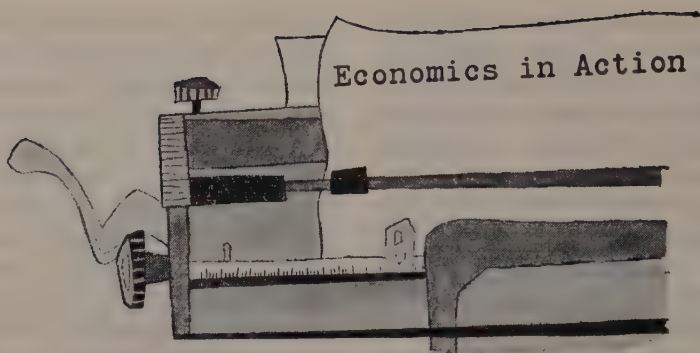
Perhaps the most effective form of competition has been product

improvement and product differentiation. The development of an antibiotic in a form that could be taken orally when existing forms were all injectables, gave the developing firm an advantage, as did the development of an improved product which remained potent in the blood stream longer. An almost infinite variety of combinations is developed as one firm after another seeks to make obsolete the old forms by producing a combined, more complicated and more effective product. Research expenditures more often yield these improved or differentiated forms than they do entirely new products in new disease areas.

Expenditures on research, detailing, promotion, free goods, product differentiation and improvement are expensive. In toto, they far exceed direct factory costs. Without them we would not have a modern ethical drug industry. To ignore them and compare direct factory production costs with selling prices may make sensational political headlines. But it does not help in understanding pricing practices in the industry, which presumably is Senator Ke-fauver's objective. ■

Romance Insurance

A BRITISH insurance broker issues policies covering a suitor whose girl goes abroad on vacation. If the girl falls in love with a Continental, the jilted British suitor collects on the policy. Premiums depend on the girl's age: the younger the girl, the higher the premium.



Wall Street uncertainty

Although the consensus of most economists and businessmen is that the long-range prospect for the U.S. economy is one of inflation (albeit creeping), Wall Street is apparently a little nervous about the immediate prospects. January saw the steepest one-month loss in *The New York Times* stock price index since 1930, a loss which brought stock averages to their lowest point in 10 months. Interestingly enough, uncertainty rather than outright pessimism is driving the market down. There have been no selling waves, but investors have just stopped buying. Activity is so light that sales of just a few shares of some stocks are enough to drive the price down several points.

Why the gloom?

Some of this uncertainty can be attributed to President Eisenhower's forecast of a \$4.2-billion budgetary surplus in fiscal 1961. It is ironic that in spite of the concern of many investors about inflationary budgets and high taxes, predictions of a budgetary surplus should cause uncertainty in the nation's financial community.

the bond market

This uncertainty in common stocks, however, has brought many institutional investors back into the bond market, which has registered impressive gains in recent weeks. This is, of course, welcome news for the

Treasury Department which found it difficult to interest investors in government securities during last year's bull market. It is also an excellent opportunity for the government to convert some of its short-term obligations into long-term ones, even though Congress remains reluctant to raise the statutory 4.25 per cent interest ceiling on long-term obligations.

**on the
wage front**

Wall Street uncertainty and potential budget surpluses notwithstanding, many economic indicators point to continued creeping inflation. The recent steel settlement is almost certainly inflationary and will undoubtedly result in increased steel prices at a more politically propitious time. On the immediate horizon lie contract negotiations in the railroad industry—negotiations again almost certain to result in wage increases. A further nudge to the inflationary spiral will probably come early next year when automobile workers' wages are renegotiated.

**inflationary
indicators**

Other harbingers of continued inflation include the persistent expansion of consumer and industrial credit, in the face of a tight-money policy by the Federal Reserve Board, and the considerable growth in spending, much of it borrowed, over the same period a year ago. New plant and equipment expenditures, for example, are currently running at a rate approximately \$5.5 billion above that of the same period last year. At the same time, the rate of commercial and industrial loans has increased by \$2 billion since June of last year, and consumer credit has increased by nearly \$6.5 billion in the past year.

the outlook

Most available evidence, then, would seem to indicate that the long-run threat to the American economy is inflation and not recession. This does not, however, rule out short-term "readjustments" which would enable the economy to gather new steam—and eventually embark on a new round of inflation. ■

THE STEEL SETTLEMENT:

IT WAS NO BARGAIN



In the absence of a third force, the "bargainers" proved that they could stand the strain better than the economy

by A. H. Raskin

■ CAN COLLECTIVE BARGAINING really protect the public interest in vital industries? Perhaps the most disquieting aspect of the way in which the steel dispute was settled is that the settlement has made politically improbable any evaluation of the need for new safeguards against crippling strikes—or equally crippling contract agreements.

In the best political tradition, top-ranking Republicans and Democrats have decided that in a Presidential election year the most feasible way to dispose of the explosive issue of new labor legislation is to do nothing about it. This decision is almost certain to be confirmed, if White House pressure and the Railway Labor Act avert a rail walkout this spring. "Peace,

it's wonderful" is as welcome a political slogan in labor problems as it is in international affairs.

Actually, relative industrial tranquility is the best setting for an unhurried appraisal of the shortcomings in our present methods of resolving disputes imperiling the national health and safety. Without the spur of mass hardship stemming from a major industry shutdown, the White House and Congress can shun panic-born expedients. Indeed, this would appear to be an ideal time to study thoroughly the efficacy of collective bargaining itself, especially in key industries, dominated by a few giant corporations, where negotiations are conducted on an industry-wide basis.

Such a study is doubly desirable

because of the doubts left by the steel settlement as to how much true bargaining there is in an industry like steel. The major steel producers and the United Steelworkers of America decided to start their quest for an agreement on May 5, two weeks ahead of schedule, on the theory that additional time would make more likely a strike-free agreement.

When the old three-year contract expired at midnight June 30, however, they had made absolutely no headway. A two-week truce, requested by President Eisenhower, brought no progress, and a 116-day strike proved equally ineffective. A national emergency injunction issued under the Taft-Hartley Act brought no apparent shift in the attitude of either side. In the end it was the intervention of the federal government that provided the key to settlement—as it had in 1956, 1952, 1949 and 1946.

The 1959 dispute was in many ways the most instructive of all because it indicated the impossibility of keeping the government out of a dominant role in steel labor-management conflicts, no matter how firmly committed the man in the White House might be to a hands-off philosophy.

The most fundamental factor during the so-called bargaining was the insistence by both the President and Congress that there could be no repetition of the wage-price

leapfrog which had become standard practice in steel since the end of World War II.

Senator Estes Kefauver's Anti-monopoly Subcommittee threatened to crack down on the companies if steel prices rose again. President Eisenhower warned both sides that he would not let the country be hurt by another surge of the inflationary spiral. For the first time the wage-price relationship became central to negotiations. Industry contended that any wage increase would have to be offset by economies brought about by changes in local work rules; the union retorted that profits were high enough to allow wage increases without increasing prices.

The White House decided to shun direct involvement in the bargaining on the ground that all past similar intervention had boosted the cost of peace and thus helped inflation.

Presidential advisers noted contentedly that a similar hands-off policy by the British government, in the London bus strike a few months earlier, had led to a settlement on substantially the terms available before the walkout. In the estimation of key White House officials, this had been a pivotal development in shoring up the whole British economy, strengthening its currency and improving Britain's world position.

Accordingly, the President de-

cided to stay out of the steel dispute, no matter how long the strike might run. He emphasized, however, that he would move for a back-to-work order under the Taft-Hartley Act whenever he felt the walkout imperiled the country. This was the beginning and end of his plan for coping with any difficulties that might arise.

Weekly reminders

Rejecting suggestions that government-appointed fact finders recommend settlement terms, since this would frustrate the bargaining process, the President issued weekly reminders that collective bargaining was on trial. These appeals made no visible impression.

Labor and management went through all the rituals of bargaining. They exchanged encyclopedic economic tracts; they brought in platoons of experts; they issued unilluminating press releases, each side proclaiming itself the sole protector of the general welfare.

They haggled over whether talks should be at the summit or at the grass roots. Sometimes union president David J. McDonald clamored to meet alone with Roger M. Blough, board chairman of United States Steel. At other times the union threatened to file unfair labor practice charges unless mass plant committees were allowed company-by-company meetings with their own managements. Re-

sult of the high-level talks: zero. Result of the low-level talks: zero.

As the strike ran its weary course, twice the length of any previous national stoppage in steel, one thing became increasingly apparent. No longer valid was the old doctrine that strikes were a test of economic muscle, in which the decision went to the party most able to hurt the other.

In fact, both sides demonstrated that they could withstand the economic buffeting far more successfully than could the country. The companies knew full well that they could satisfy all the country's demand for steel in nine months, rather than a year, and that tax adjustments would offset at least half of their short-term losses. In the end, even with 116 days of lost production, they turned out nearly eight million tons more steel than they had in 1958, when they were limited by lack of markets.

The union showed no signs of wavering, despite the record length of the stoppage. It paid no regular strike benefits, and calls for emergency aid put surprisingly little strain on its resources. The rest of organized labor raised millions of dollars to aid the strikers, but this money also proved unneeded. Even though New York was the only state in which the idle steelworkers qualified for unemployment insurance (after the eighth week of the tie-up), the great bulk of the half-

million strikers struggled through on their own resources.

The real squeeze was on the national economy. It is true that the pinch made itself felt slowly. Since the strike had been the best advertised in history, most users had built up reserves to tide them over the shutdown period. But by the end of the third month, paralyzing shortages of steel appeared in scores of factories manufacturing everything from automobiles to Christmas toys.

This ability of labor and industry to withstand each other's blows, while the country is buffeted, obviously adds a new factor to collective bargaining. It raises the question of whether it is more democratic to allow a handful of men to carry their quarrels to a point of national paralysis than it is to settle the quarrel impartially in the public interest.

Persuasive argument

This question is even more pertinent because of the way the steel dispute finally ended. The most persuasive argument used by Vice President Nixon and Secretary of Labor Mitchell was that, if the steel producers did not accept the terms recommended by the two White House peacemakers, the Democratic Congress would order worse terms. This approach smacks more of political blackmail than of high-minded effort by all parties to

work out an equitable contract.

How much better it would have been if a fact-finding exploration before the strike had set forth equitable recommendations for an accord. Such a report might, perhaps, have suggested that the fairest solution for the long-range welfare of all parties would have been a wage freeze and a price cut. The industry's ability to absorb the higher costs of the new agreement, without immediately raising prices, supports the belief that prices could have been reduced last year, had the industry wanted to keep its costs down to stave off foreign competition.

Some argue that the final contract was actually less inflationary than any of its postwar predecessors. But when one remembers that steel prices have increased four times as fast as the general price level, this may seem too slight an assurance that the long-term consequences will not be harmful. Planning the second round of labor-cost increases for December 1, 1960, too late to influence the outcome of the Presidential election, is a little too fortuitous to appear wholly coincidental.

In any event it seems clear that the Administration's main focus shifted from holding the line against inflation to guarding against another costly strike—with all the political and economic headaches it would have dragged into

the White House at the very outset of the election campaign. Within this focus the settlement was thoroughly defensible—neither better nor worse than could have been expected in the light of economic realities. Agreements with Kaiser, and with the can, copper and aluminum industries had established a pattern that was bound to control the ultimate agreement in steel. Modifications of the final accord had little effect on the inflationary influence of the original pattern.

Nature and timing

The combatants' great power to wound the economy without hurting themselves made federal intervention inescapable. But the nature of the government's role and the timing of its intervention kept this intervention from having any beneficial effect on the settlement. In other words, the Vice President and the Secretary of Labor prodded the companies to settle, although the essential elements of the contract represented the union's idea of fair settlement, with just enough dilution of previously rejected terms to enable the employers to swallow it. Even then there would have been no sale had the steel industry not been so fearful of what a Democratic Congress

would do should it be obliged to stop a second shutdown.

How all this can be described as a demonstration of free collective bargaining is difficult to see. Most of the alleged bargaining was admittedly an exercise in futility, to borrow a phrase from Mr. McDonald. No one denies that the final agreement represented a careful weighing of all the equities. The union says the employers could have had a cheaper contract without a strike. The industry says the pact is not noninflationary and adds that it signed only because it was convinced something worse would result if it waited for Congressional action.

It is to be hoped that someone in Washington will undertake a study of what can be done to keep the public from paying too high a price for breakdowns in the bargaining process. This is not the place to detail all possible ideas, much less to judge them. But it is the place to emphasize that it is a default by democracy to duck a problem of this magnitude merely because it is so big. Unions and employers have no rights that transcend those of the total community. When their quarrels hurt the public more than themselves, it is time to revise the ground rules. ■

Holiday Hunting

EIGHTY-FIVE of 1960's 366 days are legal holidays somewhere in the United States and its possessions (excluding 52 Sundays).

THE THEORY OF GAMES



OSKAR MORGENSTERN

Professor of Economics, Princeton University;
Corporate Vice President, Market Research Corporation of America

What is game theory?

Who uses it?

What kind of problems can it solve?

What are its practical applications?

How does it simplify decision-making?

TURN PAGE →

The Theory of Games

Q *Dr. Morgenstern, as coinventor with the late Dr. John von Neumann of game theory, could you tell us what game theory actually deals with?*

A Game theory tries, through the use of mathematics, to discover the best possible strategy in game situations. Broadly speaking, there are two kinds of games—games of *chance* and games of *strategy*. The difference between the two is that in games of chance only nature—that is, the laws of probability—rules. The behavior of the individual has no influence whatsoever on the outcome. Many parlor games, such as bingo, are predominantly of this kind.

Q *Does this also apply to games of strategy?*

A In games of strategy, the outcome often, but not always, depends on chance. But it also depends on the acts of the individual. Poker is a good example. And if, as is usually the case, more than one individual is involved, then everybody exerts some influence, although it is not obvious how this influence is going to be expressed—that is, what the optimal behavior of each party ought to be.

Q *Are the interests of participants in games of strategy always opposed?*

A No. Sometimes, it is true, the interests of the parties are opposed to each other. This may be the case when there are only two parties involved. We call such games *zero sum* because these are games in which, if one party wins, the other party necessarily loses, so that the sum of all gains and losses must equal zero. This is what happens in poker. If you win some dollars, I lose the same amount of dollars. The sum of our earnings and losses is clearly zero.

Q *But most games are not of complete opposition.*

A No, they are not. The moment you have at least three players, cooperation becomes an essential aspect in games of strategy. Practically speaking, this means that in most games of strategy certain players will be driven together. Of course, after their cooperation has ended they will have to divide the spoils.

Q *In other words, these may not be zero sum games?*

A That is right. Most economic and social transactions are of this kind. A business transaction, for example, is clearly a nonzero sum game since both parties win. You would not buy anything from me unless you expected the thing you buy to be worth more to you than what you pay. Conversely, I would not sell you something that is worth more to me than what I get in return. Even a war, which many people look upon as a zero sum game, is nothing of the kind since both parties will lose.

Models of economic and social behavior

Q *Well, how can game theory help us to understand such situations better?*

A Games of strategy are models of economic and social behavior—that is to say, what we find in the games we also find in reality. Of course, being a model, game theory does not give us the whole reality of game situations in social and economic life. Nor would you want it to because the full reality is so complex that you could never hope to cope with it unless you employed simplifications. But cooperation, conflict, irrationality, the presence or absence of chance, and so on, are elements that exist in most social situations. Therefore, game theory can be applied to situations where these factors play an important role.

Q *What, specifically, are some of these situations?*

A Well, the notion of strategy is obviously a military notion, and some of the most dramatic applications of game theory have been in the military field. Let me give you an illustration. In the good, old days when a battle between a fighter plane and a bomber was still of much interest, you had the problem of figuring out what the optimal behavior

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of the fighter or bomber should be. For example, you might ask yourself whether the fighter pilot should fire all of his ammunition at once or in several bursts. Such problems can be and have been solved, and the results of the solution can actually be built into the plane itself. Or, take another typical example. You have a narrow channel, such as the Straits of Gibraltar, through which submarines may have to pass. This channel is inspected by planes flying over it all the time. What is the best behavior for the plane and what is the best behavior for the submarine? This was the sort of problem for which, according to Von Neumann's so-called Minimax Theorem, there is always an optimal strategy which can be mathematically spelled out.

Q *What have been the major applications in economics thus far?*

A The typical situation of bargaining between two parties—either two individuals or a labor union and an industrial association, or the kind of competition that exists between a few producers who together control a market—is one that has been amply discussed. I believe game theory has made a real contribution to economic theory by showing that these conditions are not exceptions as they are in the classical theory of economics, but are really emanations of one and the same basic principle, the fundamental theorems of game theory.

Applications of game theory in business are often kept secret

Q *What have been some of the specific business applications?*

A Applications of game theory in business are often kept secret because the companies which use them naturally wish to keep their results from leaking to competitors. But important applications do occur. Let us say you have two or three companies in the oil industry. They must set prices for their many products. Now, these prices will depend not only on the demand, but also on the actions of a few competitors. The problem, then, is to decide what is the optimal behavior when your decisions must be made without knowing what the other party or parties will decide. Game theory can be very helpful.

Q *Could you give us an example of the kind of optimal behavior that game theory may prescribe?*

A Take a company which produces two kinds of products—let us say, refrigerators and dishwashers. Perhaps the company has a sales organization and a production organization each of which treat both of these products together. This is one way of doing it. Another way would be to have one division producing *and* selling the refrigerator and another division selling and producing dishwashers. Game theory can show that it is more efficient to have the second type of organization, if you are operating in an oligopolistic market.

Where and how game theory can help

Q *Let me ask you this. Are we going to have more business applications of game theory as our economy comes to be increasingly characterized by markets in which only a few producers compete?*

A I think that is so. Indeed, I would go a little further. Game theory illustrates abstractly the importance of cooperation in social and economic life. It is obvious, for example, that a corporation is a phenomenon of cooperation. It is also true that, over the last 100 years or so, markets have tended toward fewer and fewer production units. It is perfectly natural, therefore, that oligopolistic situations such as you describe in your question are becoming more numerous. And this is where game theory can help.

Q *How?*

A Game theory can provide solutions for situations in which you do not control all the variables. Unlike traditional economic theory, which regards the economic problem as a maximum problem—that is, as a situation where resources can be allocated in such a way as to determine maximum profits, sales, prices, and so on, because there is, theoretically, complete control over all variables—game theory recognizes that this is not generally the case in economic affairs. Some of the variables, on which the outcome of your attempted maximizing depends, are always in the control of other people whose interests may be opposed to yours. In such a situation it is not possible to describe maximum or minimum outcomes. Game theory uses entirely different concepts which take into account the decisions of other parties which are optimal for them.

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Q *Does game theory assume that your opponent is rational?*

A No, it does not. It is an important point in game theory that it does not make any assumptions about the rationality of your opponent. If your opponent is irrational—that is to say, if he deviates from his own optimal strategy—then it might be possible, in theory, to design a course of action which would enable you to profit from your opponent's deviation from his optimal strategy.

The importance of bluffing: a time-honored device

Q *How about bluffing, a time-honored device in game situations? Can game theory take care of such deceptions?*

A Yes, bluffing forms a very important part of game theory. So, for that matter, do other psychological or "irrational" aspects of game behavior, such as taboos, prejudices, etc. In any case, game theory does not necessarily describe the most rational strategy; it merely describes the optimal strategy.

Q *But what happens if both or all sides in a particular game situation use game theory?*

A Well, if all sides correctly apply game theory you will have a state of equilibrium. Each party will then be pursuing the best possible course of action. Society, as a whole, stands to benefit because you have an optimal allocation of resources and efforts.

Q *In other words, if you were to apply this idea to the field of international affairs this might be one way of promoting the peaceful resolution of conflicts?*

A That is right. If every country were to devise optimal strategies, a peaceful resolution might be more probable.

Q *But the fact that all parties use game theory would not necessarily mean that you would have a draw?*

A In zero sum games—in games where you can only win or lose—this is clearly impossible. But, as I pointed out earlier, most social and econom-

ic situations are of a nonzero sum kind, and here you have extremely difficult cases of cooperation. For example, if two people exchange goods and services they can probably both gain from the exchange. Game theory can help both parties to maximize their possible joint gains. The result would not necessarily be a draw, merely a more efficient allocation of resources all around.

Q *Does the actual application of game theory depend upon an elaborate computer technology?*

A The answer to that question is both yes and no. Yes, in the sense that some game situations can be clarified more quickly by the use of computers. If you have a really simple situation—that is, one involving only a small number of variables—then you don't need computers. But as soon as you want a more realistic model, which requires a great number of strategies, you need computers. In fact, not only do computers become necessary; they are, at present, still too crude to handle really complex situations. So far, for example, computers can handle only a very simplified chess game; a full-fledged game is still far beyond their capabilities. Complex social situations cannot be treated by computation because such situations are infinitely more complex than the fanciest computers currently on the market or on the drawing boards. So, game theory must simplify up to the point where the computer can cope with the information. Even so, the result is certainly more useful than what you would get without the help of computers.

Q *Where do you think the most important applications of game theory will take place in the future?*

A I think that in the future, as in the past, the principal applications will be in the military field, in business and in politics.

The application of game theory in politics

Q *What sort of applications might there be in politics?*

A Well, there have been some interesting studies in this field. To cite just one example, there has been some work attempting to determine the role of a Senator or Congressman in the decision-making proc-

ess of the Congress. Such studies could be extremely helpful in improving the efficiency of the legislative process. Game theory could also be used in relation to the problem of disarmament. How can agreements be reached among countries with important differences of interest who nevertheless have some remote, but real, common interest? These are questions on which game theory may have important contributions to make.

Q *And what will be the major contribution of game theory in business?*

A I think that the most important contribution of game theory here will be that it promotes a better understanding of what a market structure is. It will, therefore, lead to improved behavior on the part of individual firms and, therefore, to better organized markets. This is what a theory ultimately does. I do not know whether the widespread use of game theory would modify the social structure, but I do know that it will force us to think about the social structure in different concepts. These concepts are rather complicated and cannot very well be discussed without the use of mathematics. What is important about them is that these new concepts of game theory show that, under a given physical, legal, social, or other type environment, different social systems are possible which are free from inner contradiction. Game theory may, therefore, make some important contributions to future reform movements. But the theory is not yet sufficiently well developed for that.

Game theory makes no statement about social values

Q *Dr. Morgenstern, as you know, some people are scared by the prospect that the optimal strategies prescribed by game theory may prove "socially undesirable." How can we be sure that the strategies recommended by game theory will, in the end, prove more socially beneficial than the "Invisible Hand" of Adam Smith?*

A I am afraid such a question misinterprets the function of scientific theory. A theory tries to explain. So far, no theory of social or economic behavior—classical or modern—has ever given a value-free explanation of what a social benefit is. Assumptions of what is "socially desirable" or

not always depend on some preconceived social values. As far as the "Invisible Hand" of classical economics is concerned, I don't believe that it is a true description of what really goes on, because markets do not, in fact, tend toward free competition. In that sense, it is not a good theory. But even if it were, this would not tell you whether, on scientific grounds, it was socially preferable to other economic systems. That is a philosophical or moral question, not a scientific one. As far as game theory is concerned, it makes no statements about social values whatsoever.

Can never replace the final human decision

Q What you are saying, then, is that game theory as such cannot be held responsible for the social and moral consequences of its prescription?

A That is right. Game theory is based on a model, and if you do not introduce certain moral values into your model, these values will obviously be ignored. Game theory may, for example, prescribe the dropping of an H-bomb as an optimal strategy. But it can only do this if the dropping of a bomb is regarded as a permissible means of achieving your goal in the first place. That is why game theory as such can never replace the final human decision, for that decision will always have to consider factors which are not included in the model.

Q What, then, is the ultimate contribution of game theory?

A The main contribution, in the final analysis, is that it simplifies the decision-maker's job. It reduces the number of decisions he has to make. From the whole array of factors that the decision-maker has to consider, game theory selects those which are amenable to rigorous treatment, leaving him with a smaller residuum to cope with. In fact, game theory will probably enable the decision-maker to deal more efficiently with this residuum, for he will no longer have to worry about that part of his decision—that is, the model—which game theory can decide for him. That, I believe, is an important contribution of game theory. But the real contribution is that game theory has shown that it is possible to make rigorous and truly mathematical theory of social and economic phenomena.

Q Thank you, Dr. Morgenstern. ■

WORK RULES:



by Philip Taft

WHOSE RESPONSIBILITY?

Labor and management concede the necessity for such rules, but disagree on how they should be defined—and by whom

■ THE STEEL STRIKE has focused the national spotlight on the complex question of work rules, an often misunderstood *sine qua non* of any large industrial organization. Management and labor, for the most part, have conceded the necessity for such rules, but often disagree on who should define and administer them. Much of this discussion is embroidered with such emotional shibboleths as “management prerogatives” and “job security.”

The mass unionization which took place after the founding of the CIO in the mid-Thirties brought a tremendous increase in the number and variety of work rules as well as in the number of workers covered

by them. Many conditions which were formerly undefined or left to the discretion of the employer were now specifically drawn up. This does not mean that work rules are a relatively new development on the American labor scene; the AFL building trades unions, as well as others, had an involved code of such rules long before the founding of the CIO.

Systems of rules in one form or another govern the working lives of virtually every wage earner and salaried employee. Work in modern industry is interdependent; its flow must be arranged so as to assure the most efficient utilization of the work force. This can only be done by prescribing a system of rules

whose number and variety will depend upon the size of the plant, the nature of the work, the processes used, the type of individual employed, and even the history of the management and the union.

But while modern industry could not function without work rules, there is considerable controversy over whether these rules should be determined by the employer exclusively or in conjunction with the union.

In most unionized firms, work rules are devised jointly by unions and management. They deal with a variety of industrial practices such as hiring, transfer, promotion, layoffs, technical change, scheduling of shifts, size of crews, vacations, division of work and a host of other questions.

Workers join unions in order to limit the authority of management in areas which vitally affect them. Instead of allowing management to impose work rules at will, the union seeks a voice in their determination since its primary interest is the protection of its members from arbitrary action by the employer. In fact, the question of work rules may often be considered more important by the union and its members than such issues as wages and fringe benefits.

Differences between unions and management arise because the two parties react to changes in work rules from a different point of view.

The union regards changes from the viewpoint of their effect on the worker; the employer from their effect on costs. Nevertheless, there are wide areas of agreement on work rules between workers and management. Moreover, all unions do not approach these problems in the same manner or with the same outlook. Some unions, for example, favor seniority systems for regulating layoffs. Other unions are inclined to share whatever work is available. Similarly, the attitudes of unions toward technological change are by no means uniform. In the mass-production industries there is no restriction upon technical change; it is solely a prerogative of the employer. In other industries, the introduction of changes may require the approval of the union. Inevitably, unions seek to lessen the impact of change upon their members; this is their function and duty.

Work rules tend to reflect the kinds of problems or situations which normally exist in a particular plant. They are not the result of caprice or the attempt of one party to harass the other. A rule is the response to a given situation, and the insistence of a union on a voice in its determination is based upon a desire to avoid capriciousness, favoritism or plain disinterest in the effect of the rule on the worker.

The problem might be illustrated

by the simple requirement governing call-in pay. This type of rule, when it is part of many union agreements, requires that workers who have been asked to report, or who have not been notified in advance that no work is available for them on a subsequent shift, will be paid for a given number of hours just for making an appearance. This rule arose because many employers showed no concern for the expense and inconvenience endured by their employees in appearing on the job when no work was available. Of course, there are situations when machine breakdown, failure of raw materials to arrive or some Act of God will prevent the normal work from going on. But such contingencies can be regarded as not due to the fault of the employer, and exemptions from paying the usual call-in pay can be allowed in such instances.

Managerial pride

In other words, unions have insisted that employers were obligated to schedule their work flow so that it was available for those reporting; otherwise the employee must be notified in advance not to appear. Of course, there are instances when such a rule may impose a hardship upon management; but wisely and fairly administered it cannot appear burdensome, capricious or inequitable. Certainly, the directors of a plant who pride

themselves on their managerial prerogatives should be able to eliminate the expense and trouble involved in traveling to a job on days when work is not available.

In the longshore industry, for instance, the union and the employer determine the kinds of cargo for which higher or penalty rates should be paid. Such rates are based upon the assumption that handling some cargo, hides for example, is less pleasant than the general cargo upon which the longshoreman works. Penalty rates are also paid for dangerous cargo, such as dynamite. Some difference of opinion can arise on the degree of danger or unpleasantness, but the principle, if fairly administered, cannot be reasonably challenged.

Work rules are infinite in variety, and an attempt at their enumeration would fill volumes. A constantly changing industry must discard old or obsolescent rules if it wants to remain competitive. When a new device which will eliminate some jobs is introduced, it may be resisted, although such tactics are likely to occur almost entirely in trades employing skilled craftsmen. Obstruction through prohibiting union members from using the new device or by requiring the employment of larger numbers than are technically necessary are the historic methods for opposing such changes. Yet even industries like building construction, in

which such practices have been frequent, have introduced widespread changes in processes and materials.

Universal desire

In considering this problem, it is well to remember that restrictive policies are not necessarily confined to union organizations. The desire to protect one's market appears to be almost a universal one. Only recently, a number of trucking companies sued the railroads for interfering with their operations and collected damages under the Sherman Antitrust Law. Tariffs to retain a market, and codes and legal regulations which protect certain industries, are other examples of business firms' efforts toward retaining their customary outlets.

Some rules may be designed for the sharing of available work. Restrictions upon overtime through outright prohibition or through the imposition of high penalty rates are based upon the desire to distribute the available employment among all union members rather than upon a desire to penalize the employer. Of course, an employer facing the need to meet a deadline may find such regulations irksome and costly, but they are not designed for his harassment.

The building trades unions, which consist largely of skilled craftsmen, have often hindered technological change in the belief that a new process or machine will

wipe out a valuable skill. In contrast, the United Mine Workers of America has accepted, through most of its history, the introduction of new machinery. As a result, employment in the bituminous coal industry has declined by more than 400,000 workers since the 1920s. The union, nevertheless, has not challenged management's right to introduce new labor-saving machinery.

The administration and interpretation of work rules often raises many difficulties. Frequently, such rules have been developed over time, and on occasion a rule has been retained or introduced in exchange for some other concessions by labor. For example, a union may accept a lower wage on condition that certain workers or practices be retained so that some workers would not be laid off. Of course, if many such arrangements of this kind are made, the firm or industry may find itself loaded down with obsolescent and uneconomic practices. But the union may feel that it has exchanged lower wages for these concessions.

Explosive issue

Because of continually changing processes in American industry, disputes over work rules are inevitable. As the violent building trades strike in Chicago in the 1920s and the recent steel strike demonstrated, they are an explosive

issue, and touch the membership at many vital points. Changes in work rules must be made to meet the evolving needs of the economy. But it is doubtful whether practices that have been developed over decades can be wiped out at one swoop.

Local rules

In the steel industry, management, under its contracts with the United Steelworkers of America, has had the right to introduce any technical change it believed would afford more economical production. As many of the firms operate multiple plants which frequently produce different groups of products, local rules on various questions have been found desirable. When changes in local work rules are accompanied by a new technique, they are subject to settlement through the normal grievance procedure, to which both parties can appeal.

The demand of the steel companies for full control over local work practices was perhaps the primary reason for the continuance of the strike for almost four months. Whatever argument the companies might have for such a demand, the union could only regard it as an attempt to deprive it of a voice in an area of vital concern to the membership.

The railroad unions have not objected to the introduction of mechanical devices such as the diesel

engine or other types of heavier equipment. It is the division of the job between workers of different grades or the insistence that methods of payment developed in an era of slower trains and less modern equipment be used which are in dispute. The industry no longer enjoys monopoly in the hauling of passengers and freight. Airplanes and buses have severely affected the position of the railroad carriers and the roads are now facing serious competition for the transportation dollar. Economies have nevertheless been introduced and railroad employment is lower than it has been for many years.

Without justifying the position of the union, labor sees its reduced employment opportunities cut still further by the abolition of current practices. The result is that instead of taking the first steps toward some solution of the problem, there is complete resistance to the demand for changes. The unions fear that if they make any concessions, they will be faced with even more drastic demands for changes in the near future.

Modification of work rules presents the unions with serious problems, and it is perhaps an error for management to allow for obsolescent practices to accumulate. Since unions will not voluntarily surrender a voice in this industrial area, it behooves enlightened managements to review work rules con-

tinually so as to guard against the accumulation of obsolescent and uneconomic practices. But, in bargaining, we must remember, a price must be paid for concessions. The basic interests of the union are not different from those of management. High productivity makes for high wages, and the leadership as well as the rank and file are aware of this simple truth.

Gradual adjustment

Perhaps the least satisfactory manner of changing rules that no longer fit the operations of the firm is to allow them to accumulate and then awaken suddenly to the high costs they impose upon the firm. Unions are institutions for the slow settlement of grievances; they are evolutionary and not revolutionary organizations. The demands of the firm or an industry for a revolution

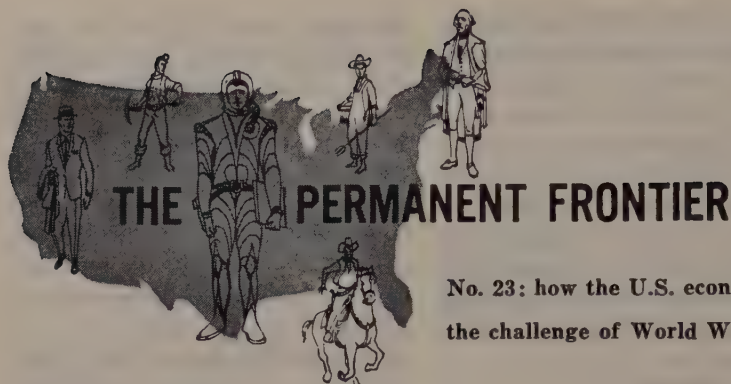
in work rules will inevitably encounter resistance. On the other hand, steady and gradual adjustment of work practice to changing needs can and is being devised by the great majority of firms. Difficulties in adjustment should be anticipated because, in the short run, these changes will affect both costs and the welfare of many individuals.

A successful management is recognized by its ability to overcome difficult problems. At various times these may involve marketing, technical development or investment. And in many important areas of the economy today, such as steel and railroads, the question of work rules is one of management's most difficult problems. An adroit management can, and must, negotiate a solution without undermining the morale or the good will of its labor force. ■

The Care and Training of Genius

A RECENT STUDY, published by the Smithsonian Institution, traces the childhood pattern of 20 great men, known to have been of high intelligence, and finds behavior patterns common to all:

- As children they were in constant association with adults, and received a high degree of attention and love from their parents.
- They were isolated from other children and formed close associations with only a few of their brothers and sisters.
- Remarkable educational programs were laid out for them by their parents.
- Among those studied were: John Stuart Mill, philosopher; Gottfried Wilhelm von Leibniz, mathematician; Hugo Grotius, jurist; Blaise Pascal, philosopher; Samuel Taylor Coleridge, poet; Voltaire (François Marie Arouet) philosopher; John Quincy Adams, statesman; Alexander Pope, poet; William Pitt the younger, statesman; and Alfred de Musset, poet.



No. 23: how the U.S. economy met
the challenge of World War II

■ IF WARS are times that try men's souls, World War II was notable as well for its test of the U.S. economy. The New Deal, for all its inspirational values and accomplishments during the preceding decade, had made only a dent in unemployment. Great doubts had risen as to the vigor of capitalism. Our wartime economic performance came just in time to impress and amaze friends and foes alike.

More earnest mobilization began in late 1940. Massive Lend-Lease operations began in 1941, when actual military expenditures for the fiscal year approached \$7 billion, equalling the *entire* federal budget of a typical prior year. By December, the spending rate for military equipment approximated \$2 billion *per month*. Unemployment, though still above five and one-half million for the year, had dropped to the lowest level since 1930.

Significant though the preparations had been, they were not enough for the efforts ahead. The depression had left a toll of old plant and equipment and idled labor skills. Unprecedented powers for coordination of procurement and production were entrusted to the new War Production Board. The War Manpower Commission had parallel authority over military and most civilian personnel. Also created was the Office of Price Administration.

This was not, however, "total war." During the peak effort, our armed forces of slightly more than 11 million persons measured up to only 17 per cent of the total labor force. National security expenditures accounted for less than 44

This is the 23rd article of a series in CHALLENGE which deals with the history and development of the United States economy.

per cent of the \$211-billion GNP in 1944 and dropped sharply thereafter even though the hostilities continued. While making what we considered an adequate war effort, we were still able to increase civilian consumption in real terms by more than 20 per cent.

The war was "total" for the United States economy only in the sense of all-pervasive central government controls. Regimentation of production and consumption still left us far more freedom than any of the other combatants.

Had people been willing to acknowledge the war's real burdens by accepting very substantial tax increases, the need for extramarket controls would have been minimized. Instead, we chose a disequilibrium system, under which the government controlled prices while allowing demand to exceed supply. Authorities then devised methods of resource allocation to mitigate the effects of this inflationary gap. Economic planning was regarded as a necessary device wherever the market mechanism might be too slow, inefficient or inequitable for emergency needs.

One approach to induce the expansion of productive capacity was to provide inducements for private enterprises to convert or expand their facilities. The government made loans and advances or guaranteed bank loans; it allowed several billion dollars worth of accel-

erated depreciation tax advantages and extended subsidies to submarginal producers of scarce raw materials. Even so, the specialized nature of many needed plants and the uncertainties of postwar markets inhibited producers from expanding sufficiently.

Government then moved directly into war-plant construction, undertaking about \$16 billion worth of construction, or almost five-sixths of wartime new plant. The government owned as much as 90 per cent of capacity in synthetic rubber, magnesium, aircraft and ships; 70 per cent of aluminum facilities; half the nation's machine tool capacity; and two major oil pipelines.

Direct controls limited production inputs for nonessentials, including civilian automobiles. A priority system ensured production of the most urgent items. Inventory controls and requisitions supplemented this system, along with production schedule and distribution directives. The Controlled Materials Plan allocated directly a small list of most critical war-stuffs: steel, copper and aluminum. Inevitable administrative complexity hindered the functioning of this plan or its extension to other materials.

Greater inefficiencies plagued resource allocation within the military sector. Continually given larger appropriations than they could transfer into procurement,

military authorities easily lost sight of existing budget and economic constraints. War Production Board attempts to introduce elements of alternative cost decision-making into military planning were most frequently resisted and termed interference. Munitions specifications to manufacturers continued largely to ignore costs.

Dampened incentives

War contractors found their incentives to economize dampened by several other institutional features of the mobilization effort. Detailed governmental scheduling proved too cumbersome for really effective control of excess military demand, and the order of contract fulfillment continued to depend on extraneous factors. The politically necessary excess profits tax led to profligate use of expense accounts. Entrepreneurial success in economizing was in any event subject to the perils of contract renegotiation because of the cost-plus terms, under which about 30 per cent of war production was handled.

Mobilization of the civilian sector was also a mixed success. Price control showed a considerable improvement over the World War I experience. On the earlier occasion, the cost-of-living index had risen 62 per cent over 1914 during our participation in the war and an equal amount after the armistice. During World War II, the com-

parable increase was about 33 per cent, with a slight decline immediately after peace. The repressed inflation did, of course, have other effects. The quality of goods and services deteriorated greatly and black markets arose in many fields. The Office of Price Administration was attacked for sins both of omission and commission.

The job of rationing consumer goods produced some inequities and, at times, inefficiencies in the name of equity. It is still debatable how much improvement was feasible in these matters. The magnitude of the sacrifice was, however, relatively minor: a certain amount of waiting in lines; some bother and limitation in sugar and coffee, meats and fats; curtailment of auto use; postponement of some appliance purchases; and some extra care in the use of shoes and canned goods. Shortages of servants, salesmen, waiters and nurses provoked grumbling, even though this was due to wage differentials rather than government action.

Granted that a major world war—even of the “conventional” sort—is a calamity in human terms, its direct economic cost to the United States is interesting to appraise. The services provided by the armed forces are, of course, difficult to evaluate in relation to their dollar costs. The War Production Board evaluated our entire production of war materials from July, 1940,

through July, 1945, at about \$186 billion in current prices. Total Lend-Lease aid accounted for roughly \$36 billion of this. By comparison, the Great Depression cost our economy, on a conservative estimate, close to \$400 billion (at lower 1939 prices) in terms of production lost through unemployment and failure to add industrial capacity. The net national debt, it is true, rose by the war's end from the post-New Deal peacetime range of \$40 billion to more than \$260 billion. Besides the fact that this was very largely internal debt, the problems raised by such expansion are financial and related little, if at all, to the war's real resource costs to contemporaries.

Who really bore the United States' share of war costs? Although President Roosevelt did propose a \$25,000 per year salary limitation, war finance was not geared explicitly to income redistribution. It was hoped, on the other hand, that the higher tax rates and broadened tax base, with accompanying wartime regulations and controls, would prevent both profiteering and privation.

Larger economic "pie"

The actual cost of the war was masked to a great extent by the fact that almost everybody was sharing in the larger economic "pie" available. Profit statistics fail to reveal a general tendency to

disproportionate gain in the corporate sector. Corporation profits before taxes did grow more than three and one-half times between 1939 and 1944, from \$6.4 billion to \$23.3 billion. But the more valid after-tax profit figure was barely more than twice as high, up to \$10.4 billion from a base of \$5 billion. GNP in current dollars had multiplied approximately two and one-third times.

Within such broad statistical generalities one can find the particulars of how some businesses prospered mightily. A government report cites fabricated structural metal products, for example, where profits after taxes rose almost sixteenfold. Smaller and medium-sized firms showed the greatest respective profits gains and were often better able to circumvent the more stringent regulations.

Unionized labor, limited by its no-strike pledge which had been reinforced by the 1943 Smith-Connally Act, looked to government for wage adjustments matching the degree of inflation. The July, 1942, Little Steel Formula set permissible general wage increases at 15 per cent, to equal the cost-of-living rise to that date.

Additional relief was gained through other means, notably a shift to fringe benefit improvements. Supplementary family incomes also helped as women and youths entered the labor force in

large numbers. Quasi-voluntary war bond deductions and voluntary saving induced by shortages increased potentially liquid assets. These were of unexpectedly great importance in the postwar period of reconversion.

Farmers fared well during the war because the government not only encouraged production, but bought this excess production for shipment overseas. Increases in productivity, with only a slight decline in numbers employed, expanded output even though five million persons left agriculture. Thus, annual farm income, although still substandard for many, rose from \$249 per capita in 1939 to more than \$700 per capita by the war's end.

Experience and change

World War II left a residue of experiences and changes which inevitably influenced postwar policies. Our achievement of full employment, albeit under the forced draft of war, generated a belief that the same thing could and should be done in peacetime. We became habituated to previously alien forms and degrees of government intervention. The federal budget has never since dropped be-

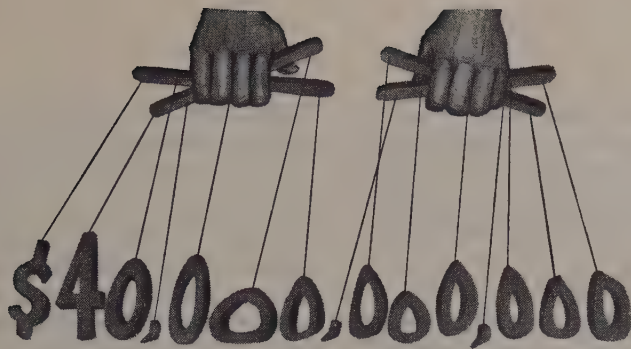
low 15 per cent of GNP, and military-connected expenditures have continued to account for half or more of that budget.

The "welfare state" was also a misnomer for the postwar situation, since many public sector needs which had degenerated during the war never did catch up. The disruptions of family and community life caused by wartime labor force shifts had brought a legacy of social costs such as inadequate housing, interrupted education, juvenile delinquency, and postponed local facilities and other public works. Of potential value was the increased awareness of national and world issues resulting from the exposure of a large mass of the citizenry to new environments, at home and overseas.

Internationally, the wartime voice of Wendell Willkie was but a vanguard of American concern for the emerging One World. It became ever clearer that West European hegemony and the colonial order were of a dying past, that demands for economic development would dominate the future.

A ravaged world turned to the major economic bastion of the West for reconstruction, recovery and reinspiration. ■

**NEXT MONTH: maintaining full employment at home
and promoting recovery abroad**



A NEW POWER ELITE?

The trustees of the nation's pension funds control more than \$40 billion

by Paul P. Harbrecht, S.J.

■ THE AMERICAN PEOPLE, though accustomed to rearranging landscapes at will, may be surprised to learn that in the last 15 years they have raised a mountain peak on the economic terrain. The new mountain consists of the assets of more than \$40 billion in pension funds. Like those who command any strategic height, the managers of these funds are in a position to dominate the countryside and, from their position, can and do deploy millions of dollars throughout the U.S. economy. Since the new mountain gives every evidence of permanence, the opinions and actions of its management will profoundly affect the winds and the weather in the broad economic plain where most of us live. It will be of value,

then, to examine this new position of command.

The assets of the pension funds are drawn from more than 25,000 pension plans covering approximately 15 million employees, or roughly one-quarter of the nation's work force. Kaleidoscopic in variety, pension plans can be divided, according to the method of financing them, into insured and noninsured types. Noninsured corporate pension funds are the larger, having more than \$22 billion in assets at the end of 1958 as against \$15.5 billion in the insured types of plans. The Securities and Exchange Commission estimates that another \$1.7 billion are held in the reserves of nonprofit organizations, multiemployer plans and union-adminis-

tered plans. In this article we shall concentrate on noninsured plans as they are less restricted in their investment scope and are thus a more dynamic factor in the economy.

Actuarial help

The typical noninsured corporate pension fund is created when the employer and the union decide, usually through collective bargaining, what benefits employees will receive on retirement. With the help of an actuary, the company then determines the amount which must be invested for each employee in order to create a fund whose income will pay employees' pensions as they fall due. Both employee and company contributions are prorated over the work life of an employee, much as life insurance premiums are calculated. Obviously, a large company with a mature pension program will accumulate a sizable amount of capital. The American Telephone and Telegraph Company, for example, has assets in its pension fund approaching \$3 billion.

The task of managing such a large capital fund is more than the average corporation is willing to undertake. Typically, an employer turns over pension funds to a financial trustee, usually a bank or trust company, for investment management. The need for expertise in managing such funds cannot be overestimated since a differ-

ence in an earning rate of one-half a percentage point, invested for a period of 20 or 30 years, can be considerable. This is probably the primary reason why corporations nearly always employ a bank or trust to manage their pension fund investments and why they impose as few restrictions as possible on the financial trustee. Indeed, the trend toward granting greater freedom to pension trustees is gathering momentum; it is a demonstrable fact that the larger the pension fund, the greater tends to be the liberty given to the investment managers.

Mountain of assets

At this point we can begin to see how the mountain of pension fund assets is accumulated. To begin with, most assets are concentrated in a relatively small number of pension funds. The SEC reports that in 1957, 14 per cent of all corporate noninsured pension funds held about 84 per cent of all the assets in 1957; 1.5 per cent of the total number of pension funds held 55 per cent of all assets in funds of \$100 million and over. The combination of many individual pension funds in a few banks makes the degree of concentration even more impressive.

The New York State Banking Department has reported that in 1954 the 13 largest banks in the state handling pension fund assets

held more than 98 per cent of such funds, leaving two per cent to the administration of 38 other banks. A careful reading of all the figures presented in the Department's report tends to show that actually some six or seven banks control 95 per cent of all pension assets in the state. At that time the New York banks administered more than 60 per cent of all the noninsured pension funds in the U.S. There is good reason to believe that the pattern of concentration in New York is duplicated in other financial centers.

Free rein

We have already observed that employers grant a large measure of freedom to corporate trustees in order to obtain maximum benefit from their investment know-how. Several other factors tend to give the financial trustees free rein in the use of the economic power the pension funds give them. The first of these results from the nature of pension fund investment. The goals of such an investment program are very long range. Obligations to be met fall due 15, 20 and 30 years in the future. The manager of a pension portfolio thus invests for long-term gains. He can make full use of dollar averaging, covering losses in one area with compensating gains in another. Liquidity requirements are low and there is a steady influx of contributions; no distinc-

tion need be made between principal and interest since earnings are reinvested; obligations to pay out are predictable long in advance, and both principal and interest in the funds are exempt from taxation. Such a situation is a veritable paradise for the investor.

The surveillance of employees and unions places little limitation on the trustees. Employees are ill equipped to judge the policies of the financial trustees, and the few court decisions extant tend to support the immunity clauses with which trustees protect themselves from suit by anyone but the company delegating investment authority to them. Similarly, court decisions have blocked labor unions from suing on behalf of employees in pension matters.

Legal restrictions by state and federal agencies are also minimal. Banking officials of both types of government limit themselves to seeing that the terms of the trust agreement between employer and trustee are being carried out and that the general laws for fiduciary investing are being observed. These latter were liberal enough to permit the trustees to invest 43 per cent of pension fund net receipts in common stocks in 1958. The federal law covering pension funds requires a report of pension fund operations, but not of items in the portfolio. Specific pension laws, thus far enacted in only six states, are prin-

cipally disclosure laws. In some instances there are provisions that make it a crime to loot or embezzle funds, but none of these laws attempts to supervise investment.

Simple verdict

If we judge the financial trustees of pension funds by the only responsibility they admittedly assume—that is, to earn as much as possible while investing according to standards of safety and prudence—the verdict is simple. They have probably done as well as could be expected, although some maintain that heavier investment in common stocks would have yield-

ed a higher rate of return. Yet a steadily increasing earning rate of 3.6 to 3.8 per cent per year is creditable. This rate would be even higher if unrealized capital gains were taken into account.

The investment record of pension trustees shows that they have been very much alive to changing values in the capital market. Thus, with each year of operation they have shifted away from government bond issues into the corporate field and from fixed income securities into common stocks. In 1958 corporate securities accounted for 83 per cent of all pension assets. In the same year 27 per cent of all

Capitalism

"WHETHER THE AVERAGE EMPLOYEE is more or less dependent upon the decisions of others than he was before the rise of the pension systems may be hard to determine. But we do know, at least, that there is a new alignment of the powers controlling him and that certain decisions he once could make are now no longer under his control. In many cases, the most evident decision-making power he has lost is whether or not he will save. With this have gone the consequent decisions as to his rate of savings, the form his savings will take and the amount he will save. Certainly it is true that the worker has lost the power of decision he would have had if his salary increases had appeared in his pay envelope rather than on the credit rosters of some pension fund. If the effect of the pension funds is to make the employee a capitalist, as many have said, he has only one of the prerogatives that make it desirable to be a capitalist—security. He gains little in the way of economic power or the freedom that economic power carries with it. Capitalist he may be, but certainly not in the sense that Marx and Adam Smith used the term."—PAUL P. HARBRECHT, S.J. in *Pension Funds and Economic Power*. New York: The Twentieth Century Fund, 1959.

assets were invested in common stocks as against 25 per cent in 1957 and 12 per cent in 1951. Such heavy investment in American business raises a question. Are the trustees of pension funds incurring responsibilities to the nation that are wider than merely earning a fair rate of return on an investment?

Such a large aggregation of capital as the pension funds represent cannot help but have an impact on the nation's economy. It is estimated that from 1953 through 1957 pension funds were responsible for investing assets equal to one-fifth of the equity capital requirements of all corporations. In the six years up to and including 1958, pension funds purchased common and preferred stock equal to 30 per cent of the net new stock issues. They now own more than one-eighth of the outstanding long-term bonds and notes of American corporations. They purchase more common stocks annually than any other group of buyers. Such a steady influx of new funds helps explain rising stock prices in the face of the recent economic recession.

It is extremely significant that these stock purchases are made in a narrow range of the highest priced stock issues because of the security required by pension investments. Pension trusts seldom sell the stocks they buy, while they do increase their total assets by

greater amounts annually and invest increasing percentages of their annual income in stocks. They will probably continue both of these trends through the next decade. Pension trusts are thus buying control of the most influential American corporations at a rather rapid pace.

Economic wind

Even now, because credit and investment are vital to the economy, directors and managers of the largest corporations must take account of the direction of the wind blowing from this new economic mountain top. The economic power that migrated from Wall Street to the corporations in the 1930s and 1940s returned to Wall Street during the 1950s in the form of pension trusts and mutual funds. The permanent institutional character of pension funds is such that economic power seemingly has returned to New York to stay. Pension trusts may never in any given instance reach the percentage of share ownership that can control a large corporation (though they easily could if they wished), but their shareholdings will inevitably be of great strategic importance. Corporate shareholding on such a scale is power—and pension trustees have it, though it may have come to them unbidden.

In the rise of pension trusts and other financial institutions we may

be witnessing an evolution analogous to an earlier one in manufacturing. At one time, the only power in industry was the muscle power of its laborers. Then, for roughly a century, the potential of the laborer's effort was steadily increased by machines. This trend has developed to such an extent that now, through automation, the laborer himself is being steadily replaced by machines.

Corporate evolution

Paralleling this evolution from hand power to machine power is the development of the corporation. At one time businesses were largely owned by individuals. Individual ownership gave place to partnerships, and partnerships to corporations. Corporations increased in size and power until James Burnham could speak of a managerial revolution—a society run by managers. And the evolution of corporations has not stopped. Corporate managers, through their pension funds, now hold shares of ownership in other corporations and can exert a pressure on the managers of these corporations. Since this is done through pension trustees, we can say that these trustees have become a real power in corporate management.

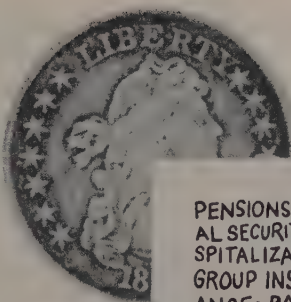
The innovation here consists in the exercise of power by virtue of managerial status rather than by virtue of personal holdings as in

the case of the Morgans, Vanderbilts or Rockefellers. The new economic princes are not owners, but salaried employees who occupy their position of authority only because they are representatives of large groups such as pensioners, policyholders and shareholders in mutual funds.

Is the new class of managers impressed with the commanding prospect from the top of the pension mountain? Probably not. While they may be growing in an awareness of their position, their attention is directed to more immediate concerns. Today's pension trustees have their eyes trained steadily on tomorrow's market quotations.

But how will they view their mountain top situation in 1970 or 1975? Pension trustees and their opposite numbers in mutual funds and insurance companies are becoming the operators of our economic system. Our society, as no other society before it, is essentially structured around its economy. As wielders of great *de facto* power, the view these men take of their position can affect profoundly the direction of our social evolution. As their responsibilities grow, and the community begins to expect more of them, they may in time be forced by circumstances to assume a formally recognized position of political responsibility in our society. It has happened in the past. ■

Accepted as a part of
progress, fringe benefits
now total
25 per cent of payroll costs



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Fringes are not frills

by Benson Soffer

■ TO MOST PEOPLE "fringe benefits" connote a miscellaneous collection of frills and benefits adding minor costs to industry's wage bill. In fact, the so-called "fringes" usually account for 25 per cent of payroll costs and support such important items as: (1) a major part of group health and life insurance costs for nearly all employees and their families; (2) the entire cost of unemployment benefits; (3) half of the contributions to the Social Security Program (covering 90 per cent of our population); (4) almost all the funds from which supplementary pension benefits are paid; and (5) paid vacations and holidays.

None of these are included in hourly wage statistics. Half the "fringe package" represents wage increases taken as time off the job, or extra wages for work under spe-

cial conditions. A three-week paid vacation, for example, adds five and three-quarters per cent to payroll costs and reduces the average workweek by three and one-third hours.

It is currently fashionable to criticize "organization men" and their concern for economic security. And the fact remains that, in relation to direct wages, income security has grown steadily in economic importance. Some critics of this trend foresee adverse effects on incentive, individual free choice, prudence and eventually on economic growth. Others fear that the growth of private benefit plans discourages improvements in government Social Security and that private insurance ties the worker to one employer.

Both sides, however, see many problems in private responsibility

for "security" in a dynamic, unstable economy.

Union members have worked through their leaders to expand the scope of collectively bargained benefits because of the eroding effects of inflation on similar government sponsored programs. Union demands for supplementary benefits seek to maintain the "benefit-to-income" relationships established in the depression. Even before income-security programs were developed, workers looked for a lifetime job with a single employer. Now, seniority has been broadened to give plant-wide, area-wide and even company-wide employment rights in large, multi-plant corporations.

The plans themselves are not revolutionary, but are based on the true economic advantages of group insurance of good-risk employees. And employers have come to realize that such plans are an essential part of the personnel policies needed to achieve a permanent labor force.

Practicality and need

Both the practicality of and the need for such "social insurance," and the desire of both labor and management to meet this need, have accounted for the rapid growth of private income security plans. What were once the prerogatives of only some salaried (and far fewer manual) employees have,

in a decade, come to be standard conditions of employment in most major industries.

Have these new benefits worked as well in practice as they do in theory? When one considers the constant experimentation conducted in the field of benefit plans and the rapid extension of these plans to companies unacquainted with them, the record is remarkable. In spite of the inevitable difficulties, no area of labor-management relations has been so free of controversy and abuse as the negotiation and administration of these programs. Costs have been estimated conservatively, benefits have been kept well within income, and responsibility has been shown in seeking meaningful benefits and efficient administration of them. There has also been a considerable amount of innovation in devising methods of spreading benefit coverage to those whose employment is irregular. And, all in all, abuse and malingering by workers have been surprisingly low.

In this responsible and constructive spirit, many "principles" which once loomed as sources of conflict have disappeared, and practical solutions to problems have been found. The employer's ability to gain tax advantages by financing noncontributory plans has encouraged the spread of this type of benefit plan. New pension benefit formulae (based on flat amounts or

percentages of recent earnings) have eliminated the possibility of retirement income lagging behind current wage levels. Almost all pension plans are funded, and past service liabilities are generally being reduced at the maximum rate allowed. Although benefits (such as pension vesting) are steadily being liberalized, payments are still below the income level of pension and supplementary unemployment benefit funds.

Rapid cost-inflation

The serious problems remaining are related to specific types of benefits—the gravest of these being the rapid inflation of medical and hospital costs. The doubling of both health insurance costs and out-of-pocket expenses in a decade casts a shadow over the actual value of all hospitalization benefit programs.

It is easy to look for a villain, but the cause of this problem is neither unnecessary treatment of the insured nor exorbitant medical fees; although instances of these abuses are not rare. The problem stems from a shortage of hospital facilities, a shortage underscored by the fact that 22 million Americans were short-term hospital patients in 1959. Medical progress raises quality, but it also raises costs. At the same time, the organization of medical care is poorly coordinated since it places

the cost of research and training on the sick. While the AMA now admits there is a shortage of doctors and encourages the expansion of medical schools, union health centers attempting the economies of group practice and preventative medical care still meet sharp resistance.

Nevertheless, little can be accomplished without the cooperation of doctors and the community organizations controlling hospitals. The newest answer is major medical insurance covering very costly illness; but under this plan the patient bears a substantial share of the cost. In 1959, 123 million Americans having health insurance received a total of \$4.7 billion from the insuring companies for medical expenses. But another \$12 billion was not covered by this insurance. It will be possible, but difficult, to solve a problem of this magnitude.

Limited in coverage

Supplementary unemployment benefits remain very limited in coverage, primarily to members of the automobile and steel unions, and such plans would not exist at all had not unions been willing to forego wage increases for them. Employers have insisted that there be no employment guarantees and that under these plans benefits for lower seniority workers (who need them most) be restricted. The result was that in the 1958 recession,

only 30 to 40 per cent of the laid-off workers were eligible for their SUB benefits.

Even fewer workers have employment guarantees. Although many employers have stabilized employment, most industries have made only limited progress. Expansion of SUB coverage will, therefore, require sizable cost increases and unions will continue to meet resistance to these plans.

Some industries, companies and plants are burdened with income security costs for the "old" work forces who find re-employment in other industries difficult for many reasons. Chief among these is that the relatively short work life remaining to older workers makes their pension and training costs disproportionately large. Multi-plant companies in such situations are often tempted to close obsolete plants when they face financial difficulty. Workers "hang around" (as in the coal fields), hoping to work enough to preserve their pension benefits. Under very adverse conditions, income security plans do not work well, but the same might be said for almost any kind of similar program.

Reasonable protection

These difficulties do not justify the fears of critics. Supplementary pension and unemployment benefits do not create a privileged class. Since there is little possibility that

legislatures will ever agree to setting government benefits at 50 to 60 per cent of wages, private benefit plans do give reasonable income protection to high wage earners. Indeed, the improvements in government benefit programs urged by the unions occurred *after* the collectively bargained programs had been started. Nor do these benefits sharply reduce labor mobility—they accentuate the already serious immobility of older, less-educated workers in declining industries which use skills that are becoming obsolete. They do not affect the mobility of the more versatile, better educated, younger workers. (The sensible approach to this immobility of labor is a positive one—for example, retrain labor through government-industry cooperation.)

Those who have feared decreasing work incentives and the growth of "legal malingering" should now realize that they were misled by class bias. Older workers have not requested unemployment pay instead of jobs. Like most other Americans, when unemployed they feel the loss of status, self-respect and income that cannot be replaced by fairly comfortable layoff pay. In fact, older workers have fought through their unions to relax compulsory retirement rules in many companies.

Security does reduce economic growth in some respects, but it probably increases growth over-all.

Protection against the adverse effects of change contributes substantially to widespread worker cooperation or ready acceptance of technological change in a dynamic economy. Both private and government insurance funds help stabilize the economy and thus encourage longer-run, more rational business and consumer decisions. Fund balances are not a net loss to the economy as they are invested in securities.

Sensible course

Present systems of income security are "paternalistic," but voluntary saving has never been adequate. Without these programs, we would still have paternalistic care for the improvident and unfortunate. Then either all taxpayers would be forced to pay for relief, or some individuals would be forced to

carry the burden of private relief. It is much easier and more sensible to prevent poverty than to cure its many evil effects.

We are much better off in our struggle to improve our systems of income security than we were a decade ago without adequate protection against the unavoidable economic hazards of modern life. There is a price to pay, but in return for planning and effort we can obtain higher quality working forces, improved management, sounder industrial relationships, and better hospital and medical care. The cost is not a serious burden if we maintain a healthy and growing economy.

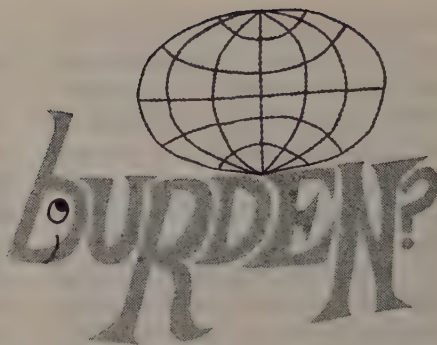
Our ability to protect the employee against the vicissitudes of the modern business and industrial world may well determine the success of our free enterprise system. ■

The Sun—Cutthroat Competitor

FRÉDÉRIC BASTIAT (1801-50), a famous exponent of *laissez faire*, wrote the "Petition of the Candlestick Makers" to show the absurdity of tariffs. Bastiat imagined the candlestick makers petitioning the legislators to shut out the sun, a foreign source of power endangering the nation:

"What we pray for is, that it may please you to pass a law ordering the shutting up of all windows, skylights. . .all openings. . .by or through which the light of the sun has been allowed to enter houses. . . And, first, if you shut up as much as possible all access to natural light, and create a demand for artificial light, which of our French manufactures will not be encouraged by it? Make your choice, but be logical; for as long as you exclude. . . (foreign manufactures), in proportion as their price approximates to zero, what inconsistency would it be to admit the light of the sun, the price of which is already at zero during the entire day!"

SHARING THE



Some European allies now spend almost as
much per capita for foreign aid as the U.S. does

by Henry G. Aubrey

■ A RECURRENT THEME of international meetings and newspaper discussions today is that Europe ought to shoulder a greater share of foreign aid expenditures. The argument goes something like this: Since the end of World War II, the United States has carried most of the burden for reconstruction, for the Atlantic defense and for world economic development. Meanwhile, Europe has not only recovered but is now moving from strength to strength. While the United States has been losing gold, Europe's reserves have grown greatly. Therefore, the time has come for Western Europe to do more.

Before we dig beneath the surface of the problem, let us clear away some deadwood. The argument implies that Europe has, so

far, done very little, or at least less than the United States, in giving aid to underdeveloped countries. But a few figures will show that this is far from the truth. About 60 per cent of the \$5 billion the United States spends annually for aid goes for military aid to help our allies carry a heavier burden of defense than their economy could otherwise sustain. Of the rest, about \$1 billion represents payments we have received from the sale of our agricultural surpluses in underdeveloped countries and which we have turned back to them in the form of aid. This sum, then, is really not a foreign expenditure at all, but the consequence of our costly program to support American agriculture.

Less than one-fifth of our total

aid bill is true economic assistance. This amounts to less than one-quarter of one per cent of our gross national product, or only about \$6 per head of our population. In 1958 France spent about \$12 per head of her population for foreign development assistance, and in 1959 she probably spent \$2 or \$3 more per head. Great Britain disburses aid at a rate of better than \$5 per head. Already this is very close to the American figure, and the amounts have been rising at a rapid rate.

It must be noted, however, that most of the amount Great Britain and France spend in aid goes to those areas where they have historical ties. This will probably continue to be true in the future. It is fair to estimate that the annual flow of capital, including private investment, from France into the French Community, and from Britain into the Commonwealth, may increase \$200 million to \$300 million within the next five years.

Bearing this in mind, it is still true, according to a computation by the United Nations, that for every \$3 the United States has spent in bilateral aid, other free-world countries have spent \$2. If American defense support were excluded, the ratio would be closer to one for one.

Developing countries received about \$2 billion in private investment during 1957-58 in addition to

the \$3 billion they received in grants and loans. The United States contributed about half of the amount spent in private investments. It must be assumed, however, that Europe has provided a substantial part of the kind of indirect capital assistance represented by the extension of private credit, although no statistics are available to prove this point. The assumption is made because European nations are more accustomed to extending this type of aid. Also, since credit insurance is available to them, they are better equipped to do so. And Europe—particularly West Germany—has been taking up a rising share of World Bank loans.

The total of American assistance is, of course, much larger than Europe's total, mostly because the United States is much larger and wealthier. The American per capita income is more than twice as high as that of some of Europe's most industrialized countries. Thus, it is by no means self-evident that Europe rather than the United States ought to do more in carrying on assistance programs. Clearly, it is easier to spare part of a large annual increment than it is to spare part of a smaller one. Even though per capita income in Europe has been growing fairly rapidly in recent years, the United States is still far ahead.

By any conventional standard of income and wealth, the United

States could certainly afford to extend more aid to other countries, but a new problem now complicates the picture. The United States, which has been helping other countries over their balance of payment difficulties for years, now seems to be facing one of its own. Payments for imports, military expenditures abroad, foreign investment and foreign aid have been exceeding receipts (foreign capital and income) from exports, investments and other services. This deficit, which used to run from \$1 billion to \$2 billion a year, has averaged more than \$3.5 billion in 1958 and 1959. Western Europe was largely the gainer, withdrawing part of its surpluses in the form of gold and accumulating the rest in dollar claims.

Faith in the dollar

To be sure, the United States still has a gold stock of nearly \$20 billion, almost half of the entire free world's gold reserve. However, in theory, holders of dollar claims could demand gold instead of dollars. If this ever happened, our gold reserves might be seriously depleted, and faith in the dollar, the world's hardest reserve currency to date, might be endangered.

This deficit must therefore be reduced. It is expected that our exports will soon recover from their present recession. Still, Europe's increasing productivity (the result

of high investments in the past) and lower wage levels mean stiffer competition for American goods in foreign markets. As a matter of fact, that competition is being felt even in U.S. markets. Reduction of our foreign investments and military expenditures would be an alternative to increasing our exports in overcoming our payments difficulties. But these expenditures ought not be determined primarily by balance of payments considerations.

Balance of payments problems are an old story to Europeans who are showing full understanding for America's new dilemma. They have been spending more and more for foreign aid all along, and are quite willing to do more. If they were to accept a larger share of this burden until our foreign balance has been stabilized at a sustainable level, it would certainly be a real help at this time. But how much more can they do?

It is true that Europe's foreign exchange reserves have been increasing spectacularly, but it may be rash to believe that they will never again present a problem. Great Britain's reserves are still far below the level that would obviate future stringencies. France recovered miraculously from her recent crisis, but a good part of her emergency loans remain to be paid. Furthermore, European prosperity has come about partly because of a

drop in import prices. Thus, to some extent, the improvement of European reserves is matched by reserve shortages in the less developed areas. A rise in raw material prices could easily remove the gloss from Europe's new prosperity.

Reshuffling responsibilities

Nevertheless, there is little doubt that Europe could bear a greater share of the common defense burden. But this would mean a fundamental reshuffling of responsibilities within NATO, an organization already faced with a number of grave problems affecting its unity and sense of purpose. This is an unfortunate time for American negotiations near or below the summit to raise fundamental financial questions.

There is less latent conflict, but also less intra-Western cooperation with regard to development aid—except for that accomplished within the United Nations. Great Britain and France, as we have stated before, are primarily concerned with development within their colonies or former colonies. Who, then, apart from the United States, can care for the noncolonial developing countries? The most obvious answer is West Germany, a country without territorial obligations and one that has by far the fastest-growing foreign exchange reserves. But Germany, too, has

limitations as a contributor to the foreign aid program.

In contrast to England and France, Germany has no organized system of governmental aid apart from the \$12 million in technical assistance, which Germany gives annually, and occasional special arrangements, such as those made with India and Egypt. But Bonn agreed to contribute \$200 million to the Overseas Development Fund of the Common Market for investment in dependent territories of other member countries, particularly of France. Also, as pointed out, Germany has taken up an increasing number of World Bank loans. Bonn has, furthermore, agreed to increase capital contribution to this organization significantly.

Credit insurance

Most of Germany's growing network of commitments in the Near East and Asia is based on credit insurance, which amounted in 1958 to about \$1 billion of insured outstanding claims against developing countries. This enables Germany to extend credit for equipment to these countries and raise the necessary finance on the German capital market. This requires only limited recourse to revolving funds or government rediscount facilities. During the last year or two, when business in Germany was not booming and claims on the capital markets

were not excessive, this system worked well enough. Whether it can be trusted to do so in the future remains a question.

The last months of 1959 were extremely buoyant, and large increases in output have been possible, even though the labor market was at a very low ebb. A new boom is clearly around the corner. But the West German Central Bank has made it quite clear that it will not permit any inflationary excesses. And the rate of interest has already been rising. In fact, this conflict may become sharper in the next boom because the German budget is now in deficit, and the capital market will have to make room for the needs of the government.

Lesson of 1957

If the course of events in 1957 can serve as a lesson, the outlook for a vastly increased capital export from Europe is not very good. In that boom year, the Swiss market for foreign loans virtually dried up. In the absence of special institutions, the financing of exports met with nearly insurmountable competition in the capital markets of the Low Countries. Similarly, in Germany, the Central Bank was of little help since exports threatened to increase inflationary pressures which, then as now, are Germany's historic fear. With that recent experience serv-

ing as a lesson, it is doubtful that West Germany will vastly increase capital exports at this time. To be sure, all legal restrictions on capital exports were recently removed; but unless the government steps in, the financial resources available on capital markets are likely to be limited by mounting domestic competition.

Hence, contributions by Germany and the smaller countries of Western Europe to the West's aid program may be restricted by internal institutional capabilities rather than by foreign exchange reserves. This does not mean that no more capital may be expected from this source. West Germany alone can probably increase capital exports by several hundred million dollars over the next five years or so. Together with the French and British contributions mentioned before, this should mean an annual increase of \$100 million to \$200 million in European contributions to foreign aid. As a matter of fact, a German publication recently mentioned \$1 billion as a feasible amount to be added by European nations in the near future. But there is no guarantee as to how much will be actually forthcoming. Besides, where private capital markets are the main source of funds, there is a limit to what the governments can or will do.

These are no small amounts but, unhappily, they are not large com-

pared with the growing needs for world economic development. The most realistic estimates call for amounts of \$2 billion to \$3 billion more than present annual capital flows to the less-developed areas. Therefore, if the United States were to do no more than maintain its present level of development assistance, Europe's additional efforts would fall far short of filling the needs.

Widening gap

In the meantime, the gap between rich and poor countries is becoming wider. Under these conditions, it is hard to see how the United States can even consider reducing its aid. At the very best, we may be able to continue for a year or two without increasing our aid, letting Europe take up a slightly greater share of the inevitably mounting total. Therefore, under realistic assumptions, the American taxpayer cannot expect any relief.

The political pressures in an era of competitive coexistence with the

Sino-Soviet bloc may call for vastly increased aid to depressed nations. The Communists are giving large amounts of assistance to areas offering political opportunities—especially in the newly independent countries of Asia and Africa. Their aid is selective. The West, however, more cognizant of world-wide responsibilities, has given more widely dispersed assistance, which runs into vastly greater amounts. India alone, whose progress by democratic methods is essential as a showcase for Western aid, will require several hundred millions of dollars yearly for the completion of the Second Five-Year Plan and for an even vaster Third Plan. And if the European capital markets become congested by domestic needs, the American economy will again be called upon to a greater extent.

In this event, the pressure of international responsibilities stemming from America's paramount position in the world may call for a response that may well overrule the economic considerations now in the foreground of public debate. ■

Answers to the Challenge Quiz

(see page 79)

- | | |
|----------------------------------|-----------------------------------|
| (1) False (<i>see page 36</i>) | (6) False (<i>see page 14</i>) |
| (2) True (<i>see page 10</i>) | (7) False (<i>see page 19</i>) |
| (3) True (<i>see page 22</i>) | (8) False (<i>see page 46</i>) |
| (4) True (<i>see page 55</i>) | (9) True (<i>see page 73</i>) |
| (5) True (<i>see page 66</i>) | (10) False (<i>see page 31</i>) |



FINANCIAL *'Best Sellers'*

Annual reports
have become significant
economic indicators

by Rudolph L. Weissman

■ SOME OF our large corporations print more copies of their annual reports to shareholders than large publishing houses print of their best-selling novels. These annual reports may be distributed to financial institutions, libraries, newspapers and even employees, as well as to company shareholders.

In cost, these reports range from a few cents to \$2 or more per copy. In format, they vary from dull and colorless leaflets to pamphlets with charts and pictures in color.

The most significant item on a company's report is the net profit, since in a pecuniary society business is conducted for profit. The acid test of profits is the return on net worth, but the proper ratio of net profits to net worth is a debatable question. Agreement is found only on the premise that profits must be sufficient to encourage investment.

While our knowledge of profits is sadly deficient for earlier periods, it appears that the ratio of profits to investment was then substantially higher than in recent years. Aggregate data are available for all current manufacturing operations from quarterly figures published by the Federal Trade Commission and the Securities and Exchange Commission. Such data show that in recent quarters the average rate of net earnings on the equity of shareholders has ranged from eight to 13 per cent—

neither particularly low nor inordinately high for manufacturing industries.

Investors today have access to more complete financial data on all levels of a company's operations than before the SEC and the New York Stock Exchange established requirements in this field. A company's annual sales volume is the very beginning of financial analysis. Yet, quite a number of corporations at one time refused to publish this basic information. Often the allowances made for wear and tear and obsolescence of equipment were not separated from other costs. And too often the method of valuing inventories was known only to insiders. Some companies did not even condescend to publish income statements; earnings had to be gleaned by comparing successive balance sheets.

Annual statement required

Today, however, companies listed on a major stock exchange or registered with the SEC must provide an annual financial statement certified by independent auditors. Many companies do more than this. They often publish five- or 10-year comparisons, with important financial ratios already worked out for the investor. Among these are (1) the ratio of current assets to current liabilities (showing the company's ability to meet future obligations); (2) the ratio of dividend payments

to net profits (showing management's readiness to pay out or reinvest earnings); (3) the book value per share of common stock (showing the size of the capital investment of common shareholders in the company); and (4) the ratio of net profits to net worth (showing earnings in relation to shareholder investments).

Included with a company's financial report is usually an open letter to shareholders from the corporation president. This letter explains various accounting items and discusses corporate developments, operations and plans for the future. It may also touch upon the tax burden, government relations, labor problems and the general state of the economy. While informative, this letter may sometimes show a bias from the viewpoint of management. It is a temptation for a company president to give the impression that increased profits are due to careful planning or that a reduction in earnings is due to conditions beyond the control of management. For this reason the facts must be examined with discrimination and objectivity.

Annual reports are documents of social significance not only because of their importance to investors, but also because they reflect the general economic scene. For example, the report of a representative electric utility company has shown that, in the last decade, the

use of electricity per residential customer rose from around 1,800 kilowatt hours to 3,600 kilowatt hours, while the price per unit fell from 2.8 to 2.3 cents per kwh. Meanwhile, the company earned an average return of about 6.3 per cent on invested capital. These facts give an encouraging picture to investors, and illustrate the extent to which our society has come to depend on electrical power.

Broad data of a somewhat similar nature could be gleaned from government data or trade reports, but these are not always readily available. Moreover, aggregate data and general information lack concreteness. For example, we know that the European Common Market is breaking down trade barriers. But the full significance of this development is brought home concretely when we read the annual report of a company such as International Harvester. Its report states that the company's German subsidiary is supplying two-cylinder diesel engines to the French subsidiary and the French plant is supplying the German plant with malleable iron castings.

Likewise, research and development expenses are one thing when described in terms of the aggregate amounts spent by all industry. The figures are far more meaningful in Union Carbide's annual report, which states that in every month of the past 25 years, re-

search has resulted in at least one new product.

Analysts, credit men, and investment and commercial bankers have developed keys or tools to help them appraise the position and progress of corporations. These vary among the different types of industries, depending on the economic and legal characteristics involved, but there are a few guides which apply equally to all enterprises. The following are examples:

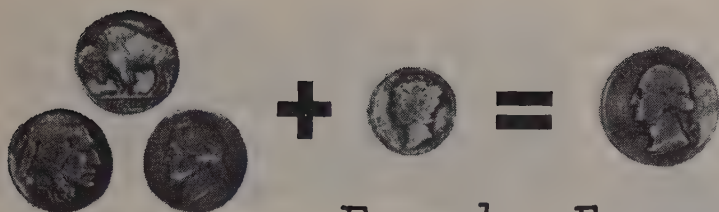
- Do not attempt to reach a conclusion from one year's statement. A two-year comparison is a minimum requirement.

- Do not consider the profit-and-loss account and the balance sheet as separate statements.

- Do not judge the financial standing of a company without looking into the standings of other companies in the same industry.

- Do not assume that any trend will continue—change is the one certainty in a dynamic economy.

Annual reports are the best source of current and precise information on the financial position of leading corporations. As such they have real practical value for investors and an educational value for those seeking to understand the inner workings of our economy. It is no wonder that classes in economics and other social sciences may be found reading annual reports of leading corporations along with their textbooks. ■



Everyday Economics

■ TEENAGERS and others who perform part-time tasks as babysitters, gardeners, chauffeurs, etc., are covered by Social Security if they earn \$50 or more in cash in three months *from any one employer*. Room and board may not be counted, but carfare counts if paid in cash. The part-time employee should show his Social Security card to the employer if he wishes to exercise his Social Security rights.

Passing the tax test



A FEDERAL income tax deduction is allowed the taxpayer for expenses incurred to maintain or improve the skills required in his employment, trade or business. If, in improving his skills, the taxpayer *incidentally* qualifies for a better position, the expenses are still deductible. However, if advancement is the *objective* the expenses are not deductible. For example, a man who is employed by an accounting

firm and takes a course to help him pass the CPA test cannot deduct the expense, whereas a co-worker who is already an accountant could deduct the cost of taking the same course which would enable him to keep up to date.

Classified pages



BUSINESSMEN who receive bills for placing their advertisement in the classified pages of the telephone directory should take a second look at the bill, warn the Federal Trade Commission and the Postal Inspection Service. Bills sent by a promoter for the placement of an advertisement in a worthless directory (if it exists at all) bear close resemblance to bona fide bills from the telephone company. The promoter may even attach a clipping of the firm's current advertisement in the classified directory. Only a careful reading of the statement accompanying the bill will disclose the "catch." Any such statements

or advertisements should be brought to the attention of the Postal Inspection Service.

Lost a bond?



IT IS important to record the serial numbers of U.S. Savings Bonds as soon as they are purchased. A bond that has been lost, destroyed or stolen will be duplicated by the Bureau of Public Debt, Division of Loans and Currency, Chicago 5, Ill., upon receipt of a statement explaining the circumstances and giving the serial number of the missing bond and its date of purchase. After investigation, the Bureau gives the owner the option of a cash refund on the bond's worth (including interest accumulated since its purchase) or a duplicate bond.

Foreign car fan



AN individual can legally avoid paying the 10 per cent excise tax on a foreign car by dealing directly with the overseas manufacturer and having him deliver the car, rather than obtaining it through the U.S. dealer. This tax advantage, however, applies only to individuals purchasing a car for their own use. Self-styled "agents" who order factory delivered cars for

customers, thereby avoiding the tax and underselling legitimate dealers, are warned by IRS agents that such sales are subject to the manufacturer's excise tax.

Dependant scholar



A PARENT must furnish over half the total support of his child during the year to claim the child as a dependent. The amount, however large, received as a scholarship by a child is not taken into account in determining total support. The value of room and board furnished a student nurse by an accredited school of nursing is considered a scholarship. But amounts received by veterans under the G.I. Bill are not scholarships and must be included in determining total support.

Two incomes?



MARRIED persons who choose to file separate income tax returns must be consistent. If one spouse itemizes deductions, the other must do likewise. If they use *Form 1040* both must take the standard deduction or both are denied the standard deduction. If one spouse takes the standard deduction, the other may not use the tax table or *Form 1040 A-S. T.*



Conservatives in Power. Edwin L. Dale, Jr. 214 pp. New York: Doubleday & Co. \$3.95.

•Mr. Dale, *The New York Times*' able economics specialist in Washington, has subtitled his book "A Study in Frustration"—and with good reason. When the Eisenhower Administration first moved into Washington in 1953, there was brave talk of reducing expenditures, of using budgetary surpluses to retire the debt, of cutting taxes and, in general, of limiting the government's role in the U.S. economy. But while the Administration succeeded in terminating the Korean war, and somewhat reducing world tensions, it has been unable to arrest the chronic expansion of budgets or the prevalence of budgetary deficits. Neither, in spite of a fairly conservative monetary policy, has the Administration been able to reverse the postwar inflationary trend. Mr. Dale's sympathetic analysis of the reasons for these "failures"—which, he believes, were almost unavoidable in a democracy—makes absorbing, if rather sad, reading.

* * *

The Afro-Asian States and Their Problems. K. M. Pannikar. 96 pp. New York: The John Day Company. \$3.00.

•Were this book as profound and penetrating a study of the problems

of developing states as its jacket portends, all would be well.

Unfortunately, this is not the case. Sardar Pannikar, presently Indian Ambassador to Paris, begins grandly with a general survey of the problems, but soon resorts to the "easy out" of generalizing from the Indian experience to cover all newly independent countries.

Since the area under study encompasses three different and quite distinct great religions, as well as numerous smaller ones and paganism, this particular-to-the-general approach leads to some rather specious conclusions.

Perhaps the most curious of these is that colonialism "*deflected* the course of their [colonial countries] *economic development*, subjecting them to a colonial system of economy." But what economic development was there to be deflected before the Western powers stepped in?

This book sheds more light on the thinking of an Indian official than on the problems which it purports to discuss.

* * *

The Weapon on the Wall. Murray Dyer. 260 pp. Baltimore: Johns Hopkins Press. \$6.00.

•Subtitled "Rethinking Psychological Warfare," this book is a penetrating study of the problems and

purposes of psychological warfare and political propaganda.

Dyer argues that a smoothly functioning system of "political communication" is crucial in the East-West struggle, but that for all our good intentions we continue to operate under the same handicaps, and to make the same mistakes, as we did in World War II.

The dropping of the atomic bomb on Hiroshima, for example, came as a surprise to the government's information office, while earlier in the war this same office had to rely on its British counterpart for information about forthcoming Allied moves.

Coordination between the policy-making and policy-explaining branches of our government, according to Dyer, is still far from the level required to assure propaganda effectiveness.

* * *

Communist China and Asia. A. Doak Barnett. 560 pp. New York: Harper & Brothers. \$6.95.

The Economic Development of Communist China: 1949-1958. T. J. Hughes and D. E. T. Luard. New York: Oxford University Press. 207 pp. \$3.60.

• Communist China's isolation during the last 10 years has made it difficult for Western observers to understand her new dynamism and the growing challenge of her influence throughout Asia. These two books will be of help to many.

Barnett's knowledge of China and her Asian neighbors equip him to explain China's influence in Asia and her relations with the Soviet bloc. His book neglects China's internal economic development, but this sub-

ject is competently developed by Hughes and Luard, despite the inevitable handicap of working from official Peiping statistics.

Barnett throws much light on such subjects as the economic and political role of the overseas Chinese, Asian pressure for recognition of Communist China and Nationalist China's disagreement with the United States.

Red China's long-term aims include the leadership of an Asia free from Western influence. Her methods can be adapted to profit from any situation. As a result, Barnett predicts that Chinese influence will continue to increase. If we are to limit her influence, we shall have to devise more flexible policies than we have up to now.

* * *

The Practical Economist. Burton Crane. 242 pp. New York: Simon and Schuster. \$3.95.

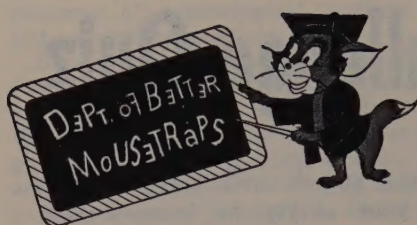
• For the "intelligent adult," this is the best introduction to economics that has come across this desk for many years. As financial writer for *The New York Times*, Mr. Crane is something of a "practical economist" himself—and, judging from this book, a very good one. Unlike so many popular writers, Mr. Crane does not "talk down" to his audience. Yet he genuinely simplifies his subject. And his book is refreshingly free from special pleadings. Objective and interesting, serious and witty, understandable and accurate, useful and substantive, this book is a godsend to the intelligent adult too busy to read a college textbook and too sophisticated to be satisfied with popularizations which tell him either what he knows or what isn't so. ■



Challenge Quiz

HOW WELL can you do with this true-false quiz? Test your ability to increase your knowledge through reading. Ten correct answers is Excellent; 9, Good; 8, Average. If you do the quiz *before* reading the articles, 6 correct answers is good. Answers on page 71.

- (1) In games of chance the behavior of the individual has some influence on the outcome.
True ☐ False ☐
- (2) During the steel strike the AFL-CIO voted against giving cash subsidies to the United Steelworkers union.
True ☐ False ☐
- (3) Percentagewise, expenditures on drugs in the postwar period have risen less than personal expenditures for household utilities and telephone service.
True ☐ False ☐
- (4) In the last 15 years, pension funds have grown to more than \$40 billion.
True ☐ False ☐
- (5) Less than one-fifth of our total aid bill is true economic assistance, amounting to less than one-quarter of one per cent of GNP.
True ☐ False ☐
- (6) The bull market of the 1920s can be traced to a widespread fear of inflation.
True ☐ False ☐
- (7) Advertising revenue covers only one-quarter of the total costs of the publishing media.
True ☐ False ☐
- (8) Call-in pay is a work rule requiring workers to appear in person to collect their paychecks.
True ☐ False ☐
- (9) Companies listed on a major stock exchange must provide an annual financial statement certified by independent auditors.
True ☐ False ☐
- (10) The major steel producers and the United Steelworkers union did not begin negotiations until the eve of the contract's expiration date.
True ☐ False ☐



From the World of Industry: Type-writer key cleaner that resembles a sheet of paper. The keys are cleaned when the sheet is rolled into the type-writer and typed upon. . . Hand-operated torch that burns oxygen and kerosene to produce a flame capable of cutting stone. The intense heat and high velocity of the torch create a mechanical energy of over 25 horsepower. Water used to cool the torch is ejected onto the stone to protect it from overheating, which might cause cracks to appear. . . Photosensitive plastic printing plate, which can be made 10 to 25 times faster than the average metal engraving, will reproduce exactly what is in the negative, making it possible to make use of photography while increasing speed in preparation.

* * *

Behind the Wheel: For parents who plan to teach their children how to drive, an automobile brake control that can be installed to the front right floor of the car so that the instructor can stop the car quickly. The brake operates as surely as the driver's, but is entirely independent of the vehicle's regular brake. . . Two solutions to be sprayed on automobile windshields come in aerosol cans. One is designed to keep ice from forming, and the other prevents windows from misting or fogging.

Week-end Living: Transparent row-boat made of lightweight plastic is eight feet long and weighs less than 50 pounds. Its transparency permits study of marine life. . . Disposable frying pans for picnics are made of strong aluminum and have handles designed to stay cool. They are sturdy enough to be washed and used again, and inexpensive enough to be discarded after use. . . Dry shaver that works on a rechargeable storage cell and gives up to 18 shaves on one charge. Two bulbs give enough light to shave in the dark.

* * *

For Better Health: *Unbreakable thermometer made of stainless steel with a clocklike dial to facilitate temperature reading. A reset button instantly returns the instrument to zero, eliminating the task of shaking it down. It is shockproof and contains a temperature-sensitive combination of metals as a substitute for mercury. . . High-fidelity hearing aid that is capable of covering approximately four octaves, creating a greater naturalness of sound than is possible with regular hearing aids.*

* * *

The Home Workman: Aerosol containers of reflective coating for roadway hazards, driveway edges and garage interiors contain enough liquid to cover an area of eight square feet. . . Layout device that helps the user stake out quickly and accurately the 90-degree angles necessary when landscaping, building walls, sidewalks, patios, etc. . . Tool that threads $\frac{3}{4}$ -inch and one-inch polyethylene pipe, making the pipe easy to use on steel and galvanized fittings.

* * *

Write to CHALLENGE magazine for further information. ■